#1 National Bestselling Author of Secrets of Self-Made Millionaire

100% of the authors' royalties will be donated to charity

Profit From The Panic

How to Make Your Fortune from the Worst Financial Crisis Since the Great Depression

Adam Khoo
Conrad Alvin Lim
Ryan Huang

Profit From The Panic

How to Make Your Fortune from the Worst Financial Crisis Since the Great Depression

Adam Khoo
Conrad Alvin Lim
Ryan Huang

ALSO BY ADAM KHOO

I Am Gifted, So Are You!

Master Your Mind, Design Your Destiny

How to Multiply Your Child's Intelligence

Nurturing the Winner & Genius in Your Child

Secrets of Self-Made Millionaires

Secrets of Millionaire Investors

Clueless in Starting a Business

Secrets of Building
Multi-Million Dollar Businesses

SPECIAL THANKS TO

Moneycentral.com
ThinkorSwim.com
Google.com
Shareinvestor.com
Finance.yahoo.com
Prophet.net

DISCLAIMER
This book contains the ideas and opinions of the author. It is not a recommendation to purchase or sell any of the securities, businesses or investment discussed herein. The author and publisher are not stockbrokers, broker dealers, or registered investment advisors. We do not recommend any particular stock, investment or securities of any kind. If particular stock and investments are mentioned, they are mentioned only for illustrative and educational purposes.

Although we have made the best efforts to provide the most accurate and up to date information, no warranty or guarantee is given regarding the accuracy, reliability, veracity or completeness of the information provided herein. The author and publisher disclaim any responsibility for any liability, loss or risk, which may arise as a consequence, directly or indirectly, from the use and application of any of the ideas, strategies or techniques in this book.

Published by Adam Khoo Learning
Technologies Group Pte Ltd
10 Hoe Chiang Road
#01-01 Keppel Towers
Singapore 089315

All right reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of Adam Khopo Learning TechnologiesGroup Pte Ltd.

This book is sold subject to the condition that it shall not, by way of trade or otherwise, be lent, re-sold, hired out or otherwise circulated without the publisher's prior consent in any form of binding or cover other than that in which it is published and without a similar condition including this condition being imposed on the subsequent purchaser.

Copyright ©2008 by Adam Khoo Learning Technologies Group Pte Ltd

ISBN: 978-981-08-2087-9

Cover, Design & Layout by: Seven Gallery Design & Consultant
Edited By: Betty L. Khoo
Project Coordinator: Chris Shia

Printed in Singapore

ABOUT THE ILLUSTRATOR

Teo Aik Cher is an educator whose words and illustrations have been featured in numerous publications. He has illustrated for Adam Khoo's best-selling books 'Secrets of Millionaire Investors' and 'Nurturing the Winner & Genius in Your Child'; the Speak Good English booklet 'Speak Well, Be Understood'; illustrated and wrote for the first and second Singapore Kindness Movement books. His cartoons are also featured regularly in the Chinese Newspapers Lian He Zao Bao where he has a weekly weekend column.

He is the author and illustrator of two best-selling books 'Why Procrastinate?' and 'Why Take Action?' which have been featured in *Teenage* magazine. He was also interviewed on 938 Live.

Aik Cher is also a Graduate of Conrad's Wealth Academy Pattern Trader Tutorial.

He can be reached at teo.aikcher@gmail.com

ACKNOWLEDGEMENTS BY ADAM KHOO

To my parents Vince, Betty and Joanne who have given me unconditional love and support throughout the years. To my wife. Sally who has been my pillar of inspiration and strength. To my two daughters Kelly and Samantha who make me smile everyday.

To my partner, Patrick Cheo, who has been sharing my vision and continually pushing me to the next level. To my partners Stuart Tan & Gary Lee for joining me on this amazing mission of empowering lives.

To my trainers Ramesh Muthusamy, Amin Morni, Melvin Chew, Danny Tong, Leroy Ratnam, Freddy Gomez, Candice Koh, Woei Tang, Yuan Yee, Jeff, Webster Ku, Pamela, Andrea Chan, Gopal, Ridhwan, Serene Seah, Adeline Wong, Ashok Menon, Joseph Ho and Cheryl Tham and who keep bringing our programs to a higher level through their passion and dedication.

who have tirelessly spent all their weekends and late nights working to build the companies at an incredible rate. Especially to my dear friends Dolly Lee, Ivy Lim, Afdoli Rahmat, Serene Quek, Siva, Andrew Ling, Katherine Sia, Rossana Chen, JD Lee, Desmond Eng, Natalie Lim, Leonard Goh, Terence Yao, Irish Ng, Wandy, Fred Tan, Dr. Peter Yan, Dr. Cheah Yin Mee, Queenie Lim, Pete Tan, Joycelina Fadjar, Yunike Wanti, Sherly Junita, Henry Aw Yong and Lawerence akalawoo.

I also want to say a big thank you to my amazing Indonesian partners and directors like Susanna Hartawan, Alien Tan, Sintawati Halim, Carmen Gomez and Anni Bahar. Thank Yous also go out to my fellow Wealth Academy trainers Conrad Lim and Yeo Keong Hee. Also to Ron Ianieri of ION Options.

Also to my friends Jovasky Pang, Adam Wong, Gary Tan, Kenneth Wong, Dr. William Tan, Andy Ong, Ong Tze Boon, Aaron Ang, Elim Chew, Douglas Foo, Sam Chia, Goh Kai Kui and Dr. Dennis Wee.

This book is also dedicated to the hundreds of coaches who have volunteered their time to continuously come back and coach for the Superkids™, 'I Am Gifted So Are You!™', 'Patterns of Excellence™' and 'Wealth Academy™' programs. We could not have done it without you!

ACKNOWLEDGEMENTS BY CONRAD ALVIN LIM

Thanks to the staff and crew, past and present, at AKLTG who busted their asses to make sure that my every need was met; Angela, Aaron, Daniel, Erlyn, Fiona, Jaqueline, Joyce, Min Jin, Niken, Pearlyn, Si Lin, Sheena, Sherly, Webster, Wei Zhong, Yan, Yunike, my slave drivers Andrew, Katherine, Queenie, Wandy and the indefatigable Terence Yao. Also to my watchful guardians Rossana, Ramesh, Stuart and Patrick.

And for every trader who passed through my doors … you have made a difference in my life.

Special mentions for my good friends and the people who never let me settle for anything less than the best; Alvin, Bernard, Ingvill, Jack, Kiat Haw, Li Min, Melvyn, Ruben, Zand and my three pillars of strength, Alicia Tan, Lawrence 'Akalawoo' Chua and Henry AYTL, without whom, the Pattern Trader would be nothing.

Amongst the many people I want to acknowledge in this book, two people stand out to deserve an extra special mention here.

The first is my very good friend and constant travel buddy in life's journey, Adam Khoo. Since helping me find myself last year, Adam has been a motivating force, a driver and leading example for everything and anything I have achieved thus far. The sharing, caring and verbal fencing we have been through over the last year has brought our friendship to another level and I know there are more great things to come from this partnership. We have learned from each other, stretched each other and leaned on each other to grow from strength to strength. Adam still continues to surprise me.

The other person deserves more than a paragraph or a page but I'll save all that for another book in the future. She puts a new level to the meaning of 'Woman of Substance'. To endure three financial downfalls and a bankruptcy and still want to stick by me, to put up with my entrepreneurial adventurism, self-destructive nature and my ever-giving-style is more than any life partner will tolerate. But Lucy, my long suffering, ever loving partner for life, endured the ultimate test of endurance with an emotional roller-coaster that threatened to tear us and my family apart earlier this year. Once again, to save our 19 year relationship, her tenacity, gumption,

determination and fighting spirit went one level up when she showed the willingness to change in order to make me change. As Adam always advocated, "For things to change, I must change first." I owe Lucy more than my life and my love, for better or for worse.

Behind every successful man, there is a woman. True. But whether the woman is a pain or a gain makes the successful man a loser or a winner.

I am a winner. Thank you, Lucy, my love.

ACKNOWLEDGEMENTS BY RYAN HUANG

This book – triggered by the financial crisis – hopes to help more people become investment savvy. With those in need among the hardest hit by the downturn, I hope the book also serves as a vehicle to generate awareness and raise funds for them. The royalties will be donated to charity.

Completing this project in less than 30 days was only made possible thanks to the great efforts from my two co-authors, Adam Khoo and Conrad Alvin Lim.

Thanks also to my pals Kevin Lau and Vikas Kumra, who love talking about their financial work, which perhaps spurred my interest in it. (Guys, you need to find new conversation topics).

A note of gratitude goes to Chung Lynyi, Go Shirkhim, and Raju Jayakumar who serve as my writing inspirations.

Last but not least, special appreciation for the support and comments in the course of writing this book from Ng Baoying, Liang Kaixin, Timothy Ouyang, Tyler Thia, and Gladys Ow.

Dedication:
For my parents Linda and George, who have given me everything

ABOUT ADAM KHOO

Adam Khoo is an entrepreneur, a best-selling author and a peak performance trainer. A self-made millionaire by the age of 26, he owns and runs several businesses with a combined annual turnover of $20m. He is the Executive Chairman and Chief Master Trainer of Adam Khoo Learning Technologies Group Pte Ltd, one of Asia's Largest Public Training Companies and Education Group. He is also the Executive Director of Adcom Pte Ltd, and a director of the Singapore Health Promotion Board (HPB).

Adam is also the best-selling author of eight other books including 'I Am Gifted, So Are You!', 'How to Multiply Your Child's Intelligence', 'Clueless in Starting a Business', 'Secrets of Self-Made Millionaires', 'Secrets of Millionaire Investors', 'Secrets of Building Multi-Million Dollar Businesses', '' and 'Nurturing the Winner & Genius in Your Child'. His books have consistently been placed on the National Best-Sellers list and have been translated into six other languages.

Adam holds an honours degree in business administration from the National University of Singapore. As an undergraduate, he was ranked among the top one per cent of academic achievers and became a pioneer in the Talent Development Program, which is the university's gifted program. In 2008, he was conferred the NUS Business School Eminent Alumni Award.

Over the last 15 years, he has trained over 355,000 students, teachers, professionals, executives and business owners to tap their personal power and achieve excellence in their various fields of endeavor.

His success and achievements are regularly featured in regional media like the Straits Times, the Business Times, the New Paper, Lianhe Zaobao, Channel NewsAsia, Channel U, Channel 8, 938Live, The Hindu, The Malaysian Sun, The Star and many more. 'The Executive Magazine' ranked Adam among the 25 richest Singaporeans under the age of 40 in 2007.

ABOUT CONRAD ALVIN LIM

Conrad, 44, is one of Singapore's few successful Professional On-Line Traders. As the resident Wealth Coach at Adam Khoo Education Group since December 2006, Conrad has trained more than 1,500 students in the art and science of trading and investing.

He is very sought after for his intimate knowledge of Technical Analysis, Candlestick Pattern Application, Sector Rotation and short term trading techniques including Day Trading and Scalping. He is also known for his unique and simplified application of Fibonacci and for his Defensive and Psychological approach to trading.

In May 2007, 'Secrets of Millionaire Investors' co-written by Conrad with Adam Khoo, was released and went on to become the nation's #1 Best Seller. It remained amongst the top 4 best-sellers for 13 straight weeks. Conrad also created and designed the 'Candlestick Patterns Quick Reference Cards' which was also released in May 2007 and has since sold more than 2,500 copies in Singapore, Malaysia and Indonesia. Along with this book, Conrad is releasing his second in the series of Quick Reference Cards, 'Breakout Patterns'.

Conrad runs his own Pattern Trader Tutorial (Wealth Academy Trader) and advanced trading tutorials for short term traders and along with Adam Khoo, he also trains at AKEG's Wealth Academy and Wealth Academy Investor programs. The demand for his Wealth programs has moved beyond Singapore's shores to Malaysia and Indonesia. In support of the Wealth programs, Conrad created and runs the Wealth Academy Investor Forum and The Pattern Trader Forum while hosting The Pattern Trader Blog and The Pattern Trader Tools website.

Today, Conrad's trading consistency is renowned as he is able to trade for US$2,500 per day trade or US$15,000 to US$20,000 a month. His trademark 5DPEG (5 Day Pre-Earnings Game), still a favorite amongst novices, continues to deliver a 92% success rate while he continues to deliver his low risk trading techniques which include the Minimal Risk Entries, PHI-Bonacci Expansion, The Standard 6 and Sector Trading.

He was featured in June/July '08 Edition of Invest magazine and is a regular speaker at ShareInvestor's InvestFair, Investor Expo and Investor's Exchange and NTU's Alumni.

ABOUT RYAN HUANG

Ryan Huang is a journalist with Channel NewsAsia, His job sees him keeping abreast of international affairs and local news. This has included reporting on the rallies at Speakers' Corner over failed Lehman Brothers-linked financial products, and the donation by Singaporean tycoon Oei Hong Leong after his gamble on one million AIG shares.

He grew up with a love for writing and is driven by a keen interest in the community, and a desire to seek and share knowledge.

Ryan graduated from Murdoch University with a bachelor's degree in Mass Communication in Journalism and Public Relations.

TABLE OF CONTENTS

Acknowledgements iii
About the Authors vii

Chapter 1 **01**
The Creation of the Financial Meltdown

Chapter 2 **15**
Understanding How Markets Work

Chapter 3 **41**
Buying Markets & Sectors in Crisis Part 1

Chapter 4 **63**
Buying Markets & Sectors in Crisis Part 2

Chapter 5 **95**
Finding Great Value Stocks Amidst the Chaos, Part 1

Chapter 6 **129**
Finding Great Value Stocks Amidst the Chaos, Part 2

Chapter 7 **145**
Finding Market Bottoms & Tops Using Patterns

Chapter 8 **171**
Starting Your Journey as a Successful Investor

1

The Creation of the Financial Meltdown

The Creation of the Financial Meltdown

These are traumatic and historic times. We are now going through the worst financial crisis since the Great Depression of the 1930s. How bad has it been? Within 14 months, the US stock market has fallen over 47% from its October 2007 high, with the Dow suffering its biggest loss in history dropping 777.68 points on the 29th of September 2008.

The Singapore Index hit a four-year low, falling over 61% from its high of over 3800 points in October 2007. It also pulled down many stocks to new 52-week lows. These are how some other markets have been affected:

Country	Index	Recent Peak		Plunge
China	Shanghai Composite	Oct 2007	5,903.64	-70%
India	Sensex	Jan 2008	20,827.45	-59%
Japan	Nikkei 225	Jul 2007	18,157.93	-60%
South Korea	KOSPI	Oct 2007	2,019.34	-54%
Hong Kong	Hang Seng	Oct 2007	31,638.2207	-65%
London	FTSE	Oct 2007	6730.70	-43%

*as of 1 Nov 2008

Victims of the Crisis

Many of the once seemingly invincible financial institutions have fallen. Headlining the shockers is the bankruptcy of Lehman Brothers, one of the largest investment banks. The 158-year-old firm was once valued at US$637 billion. Preceding that was the near-collapse of another global investment bank giant Bear Stearns. In the space of a week, its stock plunged 97% to be eventually bought over by JP Morgan for US$10 each. Both were companies which survived the Great Depression, both World Wars, and various financial meltdowns along the way.

Here are the other victims of the crisis

Name	Who they are	What happened	What since
Fannie Mae	US mortgage service giant	Loans they backed went bad, huge losses, share price plunged by over 90%	US Government Bailout
Freddie Mac	US mortgage service giant	Same as above	Same as above
AIG	US Insurance giant	Verge of bankruptcy, high of $80 to $1.25	Same as above + Government now owns 80%
Washington Mutual	Was USA's largest bank	Rumours lead customers to withdraw some 10% from its accounts, leaving bank unstable	Government steps in, sells the company to JP Morgan Chase for close to US$2 billion
Wachovia	Bank Holding Company	Fearful customers withdraw some 1% of its deposits in a "silent run"	Pressured by authorities to put itself on sale

How did this Financial Collapse All Begin?

So how did all this happen? How did companies worth billions become worthless overnight? The simple answer - bad bank practices. The roots of crisis stretches back eight years.

Stage 1: The Dot.Com Curse

The 2000 dot com bust had triggered a mild recession. This led the US Federal Reserve to cut interest rates to an all time low of 1%. Money became easier and cheaper to borrow, fueling asset inflation. It set alight a property boom, fueling home prices higher and higher.

With the bullish market, people took bigger and bigger risks. They refinanced their homes, rolling over the equity to invest in even more properties and the stock market.

Stage 2: Greedy Banks

To make things worse, banks in their greed for greater and faster profits resorted to risky lending practices. This involved subprime lending; giving loans to people with no credit history or income.

On top of that, they used other gimmicks to lure more borrowers including special introductory interest rates (promotional rates for early portion of contract) and zero down payment schemes.

Stage 3: Repackaging rubbish for salet

As banks made more of these risky loans, they found a way to pass on their risks through their financial innovation. Through a process called securitization, those debts were repackaged as financial instruments. These securities were called (Mortgage Backed Securities) and (Collaterized Debt Obligation).

The market for these CDOs and MBAs rose to the billions as banks bought them up, and in turn sold them to investors. They were attracted by the good interest rates at seemingly relatively low risks (ratings agencies have since been under fire for how they rated them). These assets got their value from the mortgages. This really meant that they needed borrowers to repay their loans for them to be worth anything.

Stage 4: The Housing Bubble Bursts

All was well and good until 2006, when the wheels of the real estate train fell off and sent house prices plunging. The catalyst for this was a situation not seen since 1974, where inflation soared while economic

growth slowed; a phenomenon known as Stagflation. The cost of oil soared to record levels (at US$140 per barrel). Costs of living went up while salaries stagnated or shrank. Home owners who had been sitting on their properties for over a decade found their homes devaluing at an alarming rate.

The huge crowd had been gambling on the value of their homes to rise. Instead, they found they had no money to meet their obligations or top up their losses. This forced many people to default on their loans. Coupled with increasing interest rates, the value of these mortgage-backed securities went into freefall.

Those billions of dollars worth of mortgage-backed assets swiftly became worthless. Many banks were forced to write-off the losses. Subsequently, the credit market for those assets became frozen.

The write-offs meant that the banks would have to raise money to meet their capital ratios and debt obligations. Amid a tight credit market, they found themselves unable to do so. Banks in the US and Europe were afraid to lend to one another, not knowing who might be the next to fall.

It's Going to Get Worse

The crisis worsened as companies and individuals counted their losses and began liquidating their assets. Fund managers dumped stocks, sending the market into further decline. After a one-month forced hiatus, short-sellers returned and joined forced sellers in the chase downward.

All this resulted in a systemic confidence problem in the financial markets. With investors holding back and others fleeing in a flight to quality or safety, liquidity became the main issue in a market already spreading its contagion around the globe.

The lack of liquidity in the markets and the lack of confidence in banks to lend to each other has caused European banks to start failing as well. Beyond the financial sector, the American economy looks set to deteriorate further. This in turn will have a domino effect on other economies, as USA is a key trading partner globally and is responsible for a large part of the world's consumption.

The world's biggest economy recorded its first quarter of negative GDP growth in October 2008, caused by

- Falling orders for durable goods
- Dropping sales of new homes
- Expected decline in exports due to strengthening US currency
- Cut in consumer spending due to fear and harder borrowing
- Expected rise in unemployment claims

Never Before Seen Market Swings

Many investors had never before experienced such an extent of fear and gloom. For many it was the first time seeing such a volatile market, particularly the wild fluctuations in the last hour of trading. Within the space of minutes, the Dow had been swinging by hundreds of points in both directions.

What's the reason for this volatility? The answer - hedge funds, the same ones that made big bets on commodities, and other sectors. They had borrowed heavily to do so, only to have their gamble backfire due to the market downturn. Soon increasingly worried clients demanded their money back, forcing the hedge funds to sell, sell and sell. Brief upswings occur because amid low trading volume, even a small number of buys can move the market.

Why the strange late hurry? Everyday at 2:45pm, these funds get ready for the following day's redemptions and margin calls. This is when they decide how much money is needed for the next day. And with all their clients pressing the panic button, the funds unload huge positions to raise the cash.

To offset their losses, these hedge funds betted on the market to go down further and shorted the S&P 500. However, they had a problem because that index partially includes defensive stocks – stocks that tend to remain stable under difficult economic conditions. This meant the funds were seeing losses on both their regular stock holdings and their short positions. What they did to save their faces, as to flood the market with sell orders to drive the index down. That helped to make their fund performance look a bit better at the end of the day.

In the face of this, the main culprits are the "fund of funds". These are the middlemen in the hedge fund world that invest client money into other hedge funds for a fee. Unlike regular hedge funds, funds of funds

have no lock-in agreement. This means clients can get their money back at any time, which adds pressure on the hedge funds in which they are invested in. Anytime a particular hedge fund fails to perform, these fund of funds cash out. This trend has been a big part of the forced selling we have seen lately.

The situation is made worse with the deleveraging by hedge funds. They are cutting back on the amount borrowed compared to their equity to reduce their risks. To do so, they usually clear their outstanding debts by raising money through selling their assets.

How is All this Going to Impact You?

As a result of the financial crisis, Europe, Germany, Japan and Singapore have all gone into a recession in the final quarter of 2008. It is a global recession. The worst-hit sectors include manufacturing and financials.

As growth slows, companies will be forced to cut back on spending and reduce costs. Layoffs and pay cuts are already taking place. Multinational giants like Citigroup, Goldman Sachs, HP, IBM and even Singapore's own DBS have announced record level job cuts. As consumers hold back on shopping, a vicious cycle threatens.

Wherever you live, the global downturn has already probably taken a toll on your income, job security, the market value of your home and the stocks or businesses you own.

The Disaster or Opportunity of a Lifetime?

"Let's recognise that this is a once-in-a-half-century, probably once-in-a-century type of event", said former Federal Reserve Chairman Alan Greenspan.

The majority of people will see this event as a horrible financial crisis and brace themselves for bad times ahead and emerge poorer. However a small group of people are looking at the same event as the GREATEST opportunity since the Great Depression. These are the same people who saw opportunities and made billions during the past crises like the 1973 Oil Shock, and the dot com crash of 2001-2003.

Billions of dollars have been made by those who bought during crises. One of them was investing great John Templeton who picked up stocks for less than $1 during the 1930s. His mantra was, "buy at the point of maximum pessimism".

Similarly legendary investor Warren Buffett bought up battered stocks when few wanted to during the 1973 Oil Shock and 2003 dot com bubble burst. That is why he has been on a buying spree, using the same strategy that has made him the world's richest man.

The Recession is Just Starting? Great! Now's the Time to Start Buying

We are just entering a recession that could last for one to three years. However, we shouldn't wait until

the economy recovers to consider investing again! That is the fatal assumption many investors make.

The stock market preempts the economy. This means the stock market's behaviour is a symptom of what will happen next. For example, the market starts plunging months before the economy goes down. Conversely, the market will move up months before the economy begins recovering.

If you look back in history, although Singapore entered a recession in mid-October 2008, the Singapore stock market started plunging 12 months before that in October 2007. Similarly, while USA showed signs of a recession in late October 2008, its stock market started its downtrend 12 months earlier.

Conversely during the Great Depression, 1932 and 1933 were both times of high unemployment and economic difficulty. However, the stock market produced a positive 34% return in 1932 and a 25% return the following year, preceding an economy recovery.

That is why uneducated investors always enter the market too late and exit too late as well. In fact history has shown that stock markets tend to start BOTTOMING when the economy begins entering a recession (like now). Before the economy recovers, the stock market would have already moved up.

So, by the time the economy recovers from a recession (one to two years from now), the stock market would

already have gone up too high and be ready for the next downturn.

The Cost of Ignorance

While you can't control how the economy is headed, you can decide whether you emerge richer or poorer. This starts from the financial decisions you make TODAY. If you do nothing, you will become poorer. If you do the wrong thing, you will also become poorer. However if you do the right thing, this could be the event that could help you retire wealthy!

You cannot just depend on what bankers or anyone else tells you anymore. You need to take responsibility for educating yourself financially. You might have heard from recent news of how people have lost their life savings from buying financial products they knew little about. Don't you agree that no one cares about your money more than yourself? It's time you take charge of your own financial future.

Many fortunes are made from decisions during economic downturns and market crashes. Warren Buffett once remarked that one must be greedy while others are fearful, and fearful while others are greedy. Adding to that, it is important to know what to be greedy with. Just buying up any stock will not make you rich. Some are just plain crappy and will never recover after dropping.

The following chapters will reveal how to make a safe investment or almost sure bets on companies and sectors that will emerge even stronger after the crisis.

2

Understanding How Markets Work

Understanding How Markets Work

History repeats itself. That's what looking at past data and studying the stock market over time will tell you. That's because human emotions – greed and fear – never change. And by using this information, you'll be able to make a good educated judgment on what will happen next after the latest crash.

To illustrate this, let's first take a look at the way the US market has performed over the last 50 years.

A Quick Lesson on Indices

An index measures the performance of the stock market. Using a basket of selected stocks, it tracks their values to represent the overall performance of that market. It also by proxy reflects the sentiment over the state of the economy.

For example, there are close to 10,000 stocks in USA. So let's say we want to know how the big companies did today. We take a look at an index called the Dow Jones Industrial Average (Ticker symbol = $INDU). It is the weighted average price of the 30 largest capped American companies (this includes: McDonald's, Coca-Cola, IBM, Pfizer, HP, IBM and etc).

If we want a broader perspective of how the US market is performing, we can take a look at a basket

that contains more stocks. This is where the Standard & Poor's 500 Index ($SPX) comes in. It measures the weighted average price of the 500 best earnings performance companies. These two indices are commonly used to represent the overall performance of the entire market.

In Singapore, there are close to 900 stocks listed on the market. Out of those, the 29 largest stocks are taken to form the Straits Times Index. When you hear on the news how the Singapore market has moved by X%, it refers to the weighted average price of the 30 largest companies (this includes: SIA, UOB, SingTel, SMRT, SGX and etc).

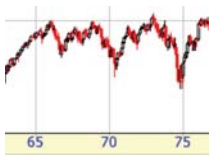
Here are the more common indices used to measure the performance of the following markets:

Country	Index	Significance
USA	Dow Jones Industrial Average	Indicates performance of: 30 largest capped American companies
	Standard & Poor's 500	500 best earnings performance companies
Singapore	Straits Time Index	29 representative companies
UK	FTSE 100	100 most highly capitalized companies listed on the London Stock Exchange
Japan	Nikkei 225	Most watched Asian index
Hong Kong	Hang Seng	45 of the largest companies on HK stock exchange
China	SSE Composite	Tracks value of 50 Chinese companies on the Shanghai Stock Exchange

The Market Always Goes Up Over Time

Now with an understanding of how indices work, let's take a look at how the US stock market has performed over the last 50 years (as indicated by the Dow & the S&P 500).

Chart 1: 50 Years Performance of the US Market (S&P 500) 1958-2008



You can see that in the short term, the stock market is highly volatile like a roller coaster ride. Every time it goes up, it will come down. Every time it drops, it will bounce back up again.

However, the important to note is that over the long term, it always trends higher. Over the last 50 years, the US stock market has achieved an **annual compounded return of 12.08%** with dividends reinvested.

People often wonder if the market has been steadily climbing up for so long, can we still expect it to continue its rise. The answer is yes! Why will it keep going up? Well, there are three reasons:

1) Inflation

Inevitable rising costs of living will always see the prices of goods & services going up. Subsequently the revenue of companies will increase in tandem in dollar terms. This will then likely be reflected in their stock price (which contributes to the value of the Index, which then rises in tandem too).

2) Growth in Demand

There will perpetually be more demand for goods and services, partly thanks to a rising global population and countries pushing for economic growth. This is especially fuelled by developing countries like China, India and other parts of Asia. As people buy more hamburgers, more computers, and more drugs, the revenues, profits, net worth of related companies will go up – in tandem with their stock prices. Remember that most of the companies that are featured on Indices do not cater to just one market, but to the rest of the world because they are Multi-National Companies.

3) Structure of Index

The index only retains the very best companies. If any of them does not do well, they are bumped off it and replaced by a better-performing company. For example on the Dow in October 2008, global insurance firm AIG was removed and replaced by

Food and Beverage giant Kraft.

In fact, if you compare the first 25 years (1957-1982) with the second (1982-2007), you will notice that the uptrend gets steeper. This means the market actually grows faster over time. The reasons for this phenomenon are technology and globalisation. Back in the 1950s and 1960s, it took 10-20 years for a company to reach a billion dollars in profit; today a company like Google achieves that same growth in less than five years.

In the Short Term, Markets Are Risky & Unpredictable In the Long Term, Markets Are Safe & Predictable

Now, let's take a look at the market performance over a shorter term 10-year period.

Chart 2: The US Market (1970-1980), Represented by the S&P 500 Index

The market goes through downtrends and uptrends within this decade. Within the window of 1970-1980, there were two downtrends and three uptrends.

Now theoretically, let's imagine that you had no clue about investing and took a stab at the market in early 1973, at the Index's highest point. As the chart shows, within two years, your shares would have dropped by 46% in value! Many people in this situation might then end up feeling that investing is an extremely risky game, sell off their shares out of fear, and exit the stock market 46% poorer.

However, if you had the knowledge that the market would ALWAYS go up over time, you would have held onto your shares and might have BOUGHT EVEN MORE at the low prices to average down the cost of your shares. If you had done this, you would have recouped your losses plus make a nice profit within another two years.

As you might tell so far, the capacity and patience to hold on to your investments for the long term will more often than not help you succeed. Even if you did not buy any additional shares during the dip, just by holding on you would have made a huge gain of over 300% by mid-1987. And by 2000, your wealth would have multiplied 13 times.

Chart 3: 50-Year Performance of the US Market (S&P 500 Index)

The Harder they Fall, the Stronger they Bounce Back

Let's take a look back at stock market crashes in recent history and see what happened right after.

The Oil Shock of 1973

Major Arab oil producers announced an oil embargo against the United States and its allies in October that year. This was in response to USA's decision to support Israel during the Yom Kippur War against Syria, Egypt, and Iraq. Oil prices rocketed affecting all parts of the economy.

Stocks crashed 45% over 24 months from 1974-1975.

Chart 4: US Market 1974-1975 (Represented by the Dow Jones Industrial Average)

They later rebounded and gained 300% over the next 12 years (1975-1987).

Chart 5: US Market 1975-1987 (Represented by the Dow Jones Industrial Average)

Black Monday 1987

The largest one day stock market crash in history (in percentage terms) took place on 19 October 1987. Panic-selling led markets to tumble on Monday starting from Hong Kong, and spread west through the international time zones.

This was aggravated by the use of computer program trading. Computers automatically issued sell orders to cut losses. This in turn triggered another round of stop-loss orders, leading to a spiraling effect (preventive mechanisms have since been put in place). A cloud of mystery still hangs over the exact causes which triggered it.

Stocks crashed 38% within two months in 1987.

Chart 6: US Market 1987 (Represented by the Dow Jones Industrial Average)

They recovered and later gained 561% over 12 years from 1987 – 2000.

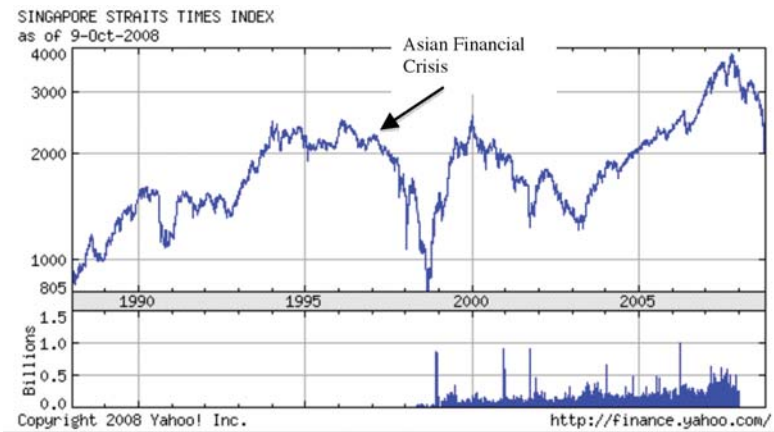
Chart 7: US Market 1987-2000 (Represented by the Dow Jones Industrial Average)

The Asian Financial Crisis 1997

The crisis started in Thailand with the collapse of its currency. This was following the government's move to end the baht's peg to the US dollar, amid heavy speculative attacks on its currency. Consequently, its value halved, and sent the Thai economy to a grinding halt. Like dominoes, the rest of Asia was affected as their currencies buckled.

The Singapore STI index crashed 64% from 2200 to 805 points. The stock market recovered everything within 14 months and gained more than 500% in the next 10 years.

Chart 8: Singapore Market 1989-2008 (Represented by the Straits Times Index) Screen Capture from Yahoo! Finance



Dot.com Bubble Burst 2001

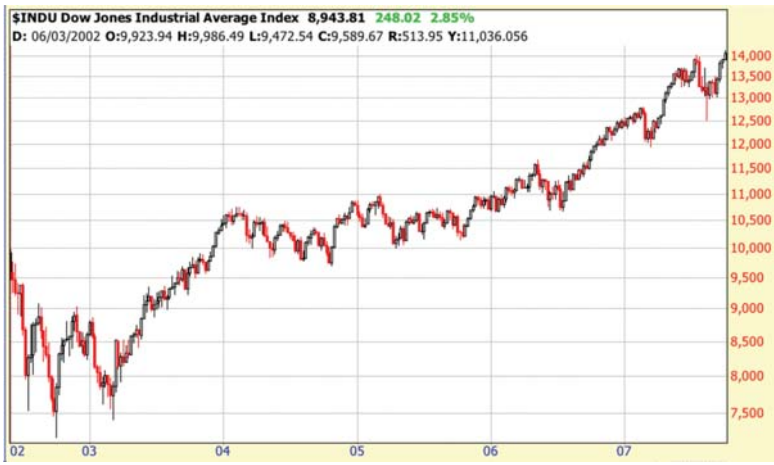
The Internet revolution began in 1995 and spawned a new online market, which companies greedily bought into. Obscene levels of speculation on the success of these companies propelled them to be grossly overvalued. This helped them to raise and borrow lots of easy capital, leading many to spend and borrow beyond what they could earn in time.

Stocks crashed 36% over 24 months from 2001-2003.

Chart 9: US Market 2001-2003 (Represented by the Dow Jones Industrial Average)

They later recovered and gained 86% over the next four years from 2003 - 2007.

Chart 10: US Market 2000-2007 (Represented by the Dow Jones Industrial Average)



Lessons Learnt from Past Market Crashes

a. Following every market crash, the overall market will not only recover its losses, but would make substantial gains in the next few years

b. Instead of panicking and selling your stocks out of fear, it would actually be more advisable to buy even more if possible

c. When you sell during downturns, you lock in real losses. But when you buy during downturns, you are setting yourself up for huge profits.

How Long Does a Recovery Take?

Studies of the last twelve bear markets in the US, shows that on average it takes the Dow three years to rebound to its previous highs. The average decline for the past twelve bear markets was 28.69%. The current crisis has already witnessed drops of over 47%. The last time this happened in 1974, it took nearly eight years for markets to recover. However each downturn is different. The fastest market recovery took just two months, during the bear market of 1981 - 1982.

A History of US Bear Markets & Time to Recover Back to Its Peak

Date	% Plunge	Time to recover to peak	
1946	-23.95%	–	10 mths
1961	-27.10%	–	14 mths
1966	-25.21%	6 yrs	

1968	-36.94%	2 yrs	5 mths
1973	-45.08%	7 yrs	9 mths
1976	-26.87%	3 yrs	–
1981	-24.13%	–	2 mths
1987	-36.13%	1 yr	9 mths
1990	-21.16%	–	6 mths
2000	-19.91%	5 yrs	6 mths
2001	-27.36%	4 yrs	6 mths
2002	-31.49%	3 yrs	–
2007	-45%	–	–
AVG	–	3 yrs	–

So, does this mean that you may have to wait up to 3-7 years to break even on your investments before making a profit? The answer is no. If you were to continue buying stocks at the low prices (during the plunge), you would averaged down your purchase price and be able to make a profit within a few months.

A History of Singapore Bear Markets & Time to Recover Back to Its Peak

Date	% Plunge	Time to recover to peak
Jul 90 – Sep 90	-29%	3 months
May 97 - Aug 98	-58%	8 months
Dec 99 – Feb 03	-49%	3 years

50 Years of Gains and Losses from the Market

Let's now look at specific year-on-year gains and losses from the market to gain a clearer understanding.

At a glance, you would observe that were a lot more winning years than losing years, with the losses interspersed in no particular pattern.

Table 1: 50 Years of Gains & Losses from the S&P 500 (1-year periods)

1957	-13.40%	**1967**	+20.09%	**1977**	-11.50%	**1987**	+2.03%	**1997**	+31.00%
1958	+36.90%	**1968**	+7.66%	**1978**	+1.06%	**1988**	+12.39%	**1998**	+26.67%
1959	+8.03%	**1969**	-11.36%	**1979**	+12.31%	**1989**	+27.25%	**1999**	+19.53%
1960	-3.00%	**1970**	+0.10%	**1980**	+25.77%	**1990**	-6.56%	**2000**	-10.14%
1961	+24.28%	**1971**	+11.67%	**1981**	-9.73%	**1991**	+26.31%	**2001**	-13.04%
1962	-11.80%	**1972**	+15.63%	**1982**	+14.76%	**1992**	+4.48%	**2002**	-23.37%
1963	+18.89%	**1973**	-17.37%	**1983**	+17.26%	**1993**	+7.06%	**2003**	+26.38%
1964	+12.97%	**1974**	-29.72%	**1984**	+1.40%	**1994**	-1.55%	**2004**	+8.99%
1965	+9.06%	**1975**	+31.38%	**1985**	+26.36%	**1995**	+34.13%	**2005**	+3.00%
1966	-13.09%	**1976**	+19.15%	**1986**	+14.62%	**1996**	+16.36%	**2006**	+11.89%

Out of the last 50 years, there were 14 losing years and 36 winning years. So, if you had randomly invested in a 1-year period, you would stand a 72% chance of making money and a 28% chance of losing money. These are not bad odds, considering the fact that it was purely random, without the use of any investing strategies.

What if you were willing to hold your investments for at least five years? In the last 50 years, there were ten 5-year periods. You can see from the table below that every single five-year period ended with a gain.

Table 2: 50 Years of Gains & Losses from the S&P 500 (5-year periods)

1957-1961	+54.87%	**1982- 1986**	+97.77%
1962-1966	+12.27%	**1987- 1991**	+72.23%
1967- 1971	+27.09%	**1992- 1996**	+77.62%
1972- 1976	+5.26%	**1997- 2001**	+54.99%
1977- 1981	+14.04%	**2002-2006**	+21.66%

This suggests that if you were to invest at any random time and be willing to hold your investments for at least five years, you would have a 100% chance of gain and a 0% chance of loss. However, this is NOT a GUARANTEED strategy. There are exceptional 5-year periods that ended with a loss of up to 10%. However, you can easily ride that out by holding it a little longer because you are almost assured of positive gains if you hold on for over five years.

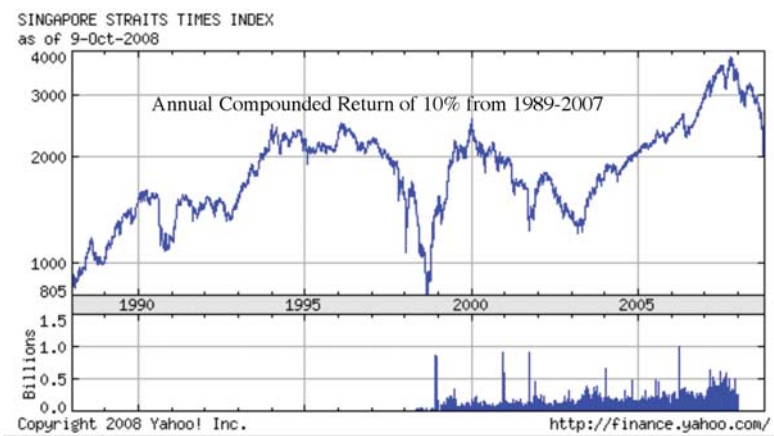
What if you were to stay invested for ten years? In the table below, you can see that there are five 10-year periods in the last 50 years. Again, every single one of those 10-year periods ended positive. This confirms that if you were to invest at any given time and be willing to hold your investments for at least 10 years, you will have a 100% chance of making a profit and a 0% chance of making a loss. So, historically, staying invested for at least 10 years gives you the opportunity to achieve an annual compounded return of 12.08% RISK FREE.

Table 3: 50 Years of Gains & Losses from the S&P 500 (10-year periods)

1957- 1966	+73.87%	**1987- 1996**	+205.88%
1967- 1976	+33.77%	**1997- 2006**	+88.56%
1977- 1986	+125.36%		

Does the Same Hold True for the Singapore Stock Market?

Chart 11: Singapore Market 1989-2008 (Represented by the Straits Times Index) Screen Capture from Yahoo! Finance



Let's see if the Singapore stock market behaves in the same way. From the chart above, you can see that the Straits Times Index (STI) goes through uptrends and downtrends in the short term. Again, in the long-term, it always ends up going higher. For the last 19 years, the STI has achieved an annual compounded return of 10%.

From Table 4 below, you can see that over the last 20 years, there were 12 winning years and eight losing years for the Singapore stock market (STI). If you had randomly invested in a 1-year period, you would stand a 60% chance of gain and a 40% chance of loss.

Table 4: 20 Years of Gains and Losses for Straits Times Index (1-year periods)

1988	+24.6%	**1993**	+58.4%	**1998**	-8.3%	**2003**	+32.1%
1989	+43.2%	**1994**	-8.3%	**1999**	+77.1%	**2004**	+15.3%
1990	-22.9%	**1995**	+0.9%	**2000**	-25.4%	**2005**	+13.4%
1991	+28.1%	**1996**	-1.8%	**2001**	-14.4%	**2006**	+26.0%
1992	+3.0%	**1997**	-31.2%	**2002**	-17.5%	**2007**	+15.0%

From Table 5, you can see the STI divided over 5-year periods. Out of four of the 5-year periods, two periods ended with gains, one period broke even and one period ended with losses. This means that if you were to stay invested for at least five years, you would have a 50%-75% chance of gain and a 25% chance of a loss.

Table 5: 20 Years of Gains and Losses for Straits Times Index (5-year periods)

1988 - 1992	+82.87%	**1998 - 2002**	-11.67%
1993 - 1997	+0.0%	**2003 -2007**	+160%

However, if you were to stay invested for at least 10 years, Table 6 shows you that like the US market, your chance of gain would be 100% and your chance for

loss would be 0%. In other words, staying invested for at least 10 years almost guarantees that you will achieve a near risk free return (historically), achieving a 10% annual compounded return on average.

Table 6: 20 Years of Gains and Losses for Straits Times Index (10-year periods)

1988 - 1997	+83.51%
1998 - 2007	+129.4%

Lessons from Studying Stock Markets

So, what are the conclusions we can draw from studying the behavior of stock markets over different periods of time? Well, there are four main points:

#1) In the Short term, the Market is Volatile.

#2) In the Long term, the Market Always Goes up.

#3) The Longer You Stay Invested, the Lower the Risk.

#4) You Always Win if You Hold Long Enough.

Very Important Note!!!
Do bear in mind that these points only apply to the MARKET INDEX which represents the whole market and not to every individual company stock.

If you buy the shares of a lousy company, then its price could NEVER recover. In fact, it may even go

bankrupt. It is the market index (which represents the largest and most profitable companies) that will always go higher over time. However, when you know how to pick fundamentally strong and profitable companies (you will learn this in chapter 4), its stock price will not only rebound, but will go even higher than the market index.

The No-Brainer Way of Making Guaranteed Profits

From your understanding of how markets work now, can you see that there is actually a NO-BRAINER way of making guaranteed profits from the stock market?

The trick is to just buy the MARKET INDEX like the S&P 500 Index, the Dow Jones Index or the Straits Times Index. In the next chapter, you are going to learn how to buy the markets through investment instruments known as ETFs (Exchange Traded Funds).

Why Most People Lose Money in the Markets

If the stock market always recovers and goes higher over time, why is it that the majority of people (80%) lose money?

The main reasons are because most people make investment decisions based on the short term and not the long term (most people are impatient and greedy). At the same time, they make decisions based on EMOTIONS and not logic. The two emotions FEAR

and GREED cloud rationality. This leads people to make loss-making investment calls. For example, many people often get caught up in the euphoria of good times amid a bull run, buying even when the market is overpriced (i.e. during the dot com bubble of 2001).

At the same time, emotions cause people to sell when theirs stocks dip over a long stretch of time. As they see the value of their stocks getting lower and lower, their FEAR of losing more will cause them to sell at low prices.

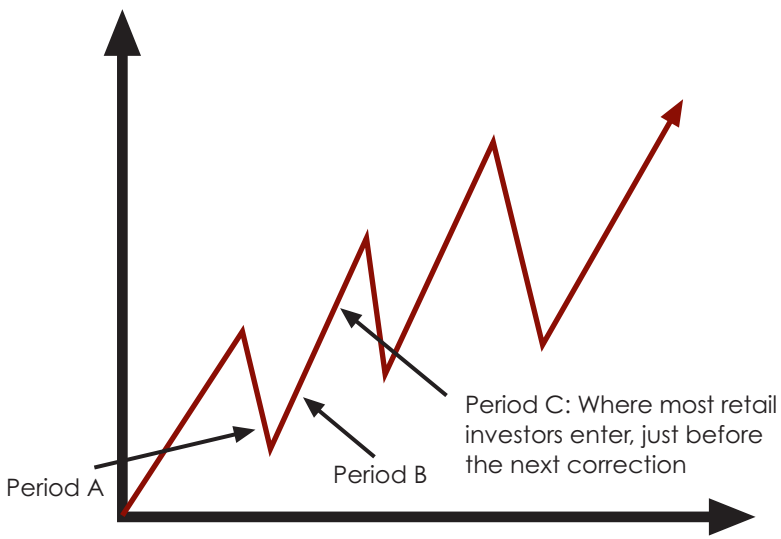
The best way to protect yourself from such emotions, is to understand how the market works. A lack of knowledge gives fertile grounds for such emotions to manifest. It opens your eyes to realize where the windows of opportunity and traps are.

Many people tend to invest when they have seen that stock prices have been going up after some time. The first thing salespeople selling bank products will show you is how well their fund has performed over the last 3-5 years. This past performance creates an impression and the confidence that prices will keep going up. The temptation to make money from this uptrend is what draws most people to invest.

However, we now know from studying the cycles of the stock market that what goes up after some time (especially 3-5 years), will come down. This is called a correction! This is why most people have the common experience of seeing their stocks fall after investing.

With knowledge of how the cycle works, market downturns are logically the best time to be buying. This is because EVERY MAJOR DOWNTURN or crash is followed by the next bull run.

Recall that the chart of a typical stock market index looks like this:



Again, the majority of ignorant and untrained investors will NOT invest during period A (during the downturn) or period B (just after the crash), although these are the BEST times to get in. After selling their shares during period A (out of fear of losing everything), they will usually not dare to enter the market anytime soon.

During period B (the beginning of a new uptrend), the average investor will also stay away. The painful memory of losing money will keep them away from the market.

During period C (during the end of the uptrend), when the market has delivered consistent returns over a few years, is where investors will start to gain confidence again and their greed will overcome their past memories of loss. This is when they will jump in, just before the next correction.

The next thing they know, the market dips again just after they have invested. This cycle keeps repeating year after year and is what causes most people to lose money in a stock market that actually keeps going up over the long term.

So, knowing all these, what strategies can we use to make money consistently and profitably from the markets? Let's find out in the chapters that follow…

3

Buying Markets & Sectors in Crisis Part 1

Buying Markets & Sectors in Crisis Part 1

In the previous chapter, you would have learnt that stock markets always recover from downturns. They then eventually bounce back higher than before.

How do we take advantage of this? What's the best bet buy for the market rebound?

Well, the simplest sure-win strategy is to just BUY THE MARKET. In other words, buy the index.

Using Exchange Traded Funds to Buy the Market

Well, in reality the index is not on sale. However, you can buy what is called an Exchange Traded Fund (ETF), which tracks the market index you are investing in. There are ETFs that track the Dow Jones Index, the S&P 500 Index, the Nikkei 225, the Straits Times Index and etc.

The process of buying an ETF is exactly the same as how you would buy any other stock. It is listed on the index like a stock. However, instead of buying a share in one company, you are actually buying a basket of top stocks that make up that index. In a sense, an ETF is a vehicle constructed like a unit trust/mutual fund, but with the convenience and liquidity of a stock.

Why Buy ETFs Instead of Mutual Funds?

You may be already familiar with the concept of unit trusts (also known as mutual funds). This is an investment scheme where a fund management company pools money from thousands of small investors. A fund manager will take all this cash and invest it in a portfolio of stocks.

There are many mutual funds that are specially constructed to track the index. In such cases, the fund manager simply takes the investors' cash and invests it in the same component stocks that make up the index. This is known as an index fund. This basket of stocks concept is similar to the structure of the ETF.

However, the problem with index funds and mutual funds is that they usually have HIGHER SALES FEES from the banks, as well as management fees. On top of that, you cannot buy and sell your funds as easily as how you would for a stock. The price of your fund is usually only quoted at the end of the day and you will have to go through a longer process of redeeming your money.

Most funds also lock the investor into a minimum period, which does not allow premature withdrawal without due penalties. This means you have to hold on to the fund even when it is losing a considerable amount of your capital. Such contracts can range from a year to four years and longer.

You can get around all those charges and the rigidity with an ETF. It offers the flexibility of a stock, since it is listed on the stock exchange. This means unlike unit trusts, you can buy and sell ETFs at any time. They have very low management fees, ultimately meaning higher returns for you.

Various Kinds of Exchange Traded Funds (ETFs)

There are hundreds of ETFs in the market that you can choose from. The most popular ETFs are grouped into the following broad categories;

a) SPDRs (also known as 'Spiders')

Standard & Poor's Depository Receipts (SPDRs) are a family of ETFs that are managed by State Street Global Advisors. You can find out more about SPDR ETFs at www.ssgafunds.com and www.sectorspdr.com

b) iShares

iShares are one of the largest families of ETFs that are managed by Barclays Global Investors. You can find out more at www.ishares.com

c) HOLDRs

Holding Company Depository Receipts (HOLDRs are another type of ETFs marketed by Merrill Lynch. Unlike other ETFs, HOLDRs can only be bought and sold in 100-share increments. To find out more, visit www.holdrs.com

A Small Word of Caution

Unlike regular mutual funds, ETFs prices do not always reflect the net asset values of their underlying stocks. Instead, the market price of an ETF is determined by market forces of demand and supply for its shares. As a result, there is a possibility that ETFs may from time to time, trade at prices above or below the value of their underlying stocks.

However, by allowing large investors to exchange large amounts of ETF shares to redeem the shares in-kind, the fund companies behind ETFs have created an arbitrage mechanism that prevent sustained discounts or premiums from occurring.

The Most Popular ETFs that Track the Market

With all the hundreds of ETFs available in the market, here are the more popular ones for tracking the indices of some key markets.

1) The Straits Times Index ETF (STI ETF)

Buying the STI ETF is one of the best ways to ride on the performance of the Straits Times Index. It is an ETF that is designed to track the STI, which comprises the top 29 listed companies.

Here are the FAQs and the answers:

What is the minimum size to buy?

One lot (1,000 shares).

How is it priced?
Usually slightly above 1/1,000 of the STI level. For example, if the STI is at 1,600 points, each share of the STI ETF would be approximately $1.70.

Will I get any dividends?
Yes, it pays regular cash dividends of 3-4% annually.

Who is the Fund Manager taking care of the ETF?
State Street Global Advisors Singapore Ltd.

What is the Annual cost?
0.3% (includes management fee, trustee fee & other fund expenses)

How do you Buy or Sell it?
You can trade shares of the STI ETF through any Singapore broker. Just a slight concern to note is that knowledge and thus popularity of Singapore-listed ETFs is growing but in its early stages. As such, they tend to have relatively lower volume and liquidity compared to those listed on the US exchanges.

Chart 12: Five-Year Performance of the Straits Times Index
Screen Capture from shareinvestor.com

As the chart above shows, the STI plunged 61% from its high of 3,800+ points to a low of 1500 points as a result of the crisis. Is this now a good time to invest, since we know that the market will always recover and move to even greater highs?? Find out in the later part of this chapter.

2) Standard & Poor's Depository Receipts Series 1 (SPDR-Spider), Ticker Symbol : SPY

Buying the SPDR Series 1(ticker symbol; SPY) is one of the best ways to ride on the performance of the S&P 500 Index. It is an ETF that is designed to track the top 500 listed companies. Here are some key facts about the SPY.

What is the minimum size to buy?
1 share.

How is it priced?
Approximately 1/10 of the S&P 500. For example, if the S&P is at 1,000 points, each share of SPY would be approximately US$100.

How much is the fee?
0.1% annually in operation fees

Will I be paid dividends?
Yes. The SPY price reflects its share of dividends accrued in the Trust.

How do I Buy or Sell it?
The SPY is listed on the American Stock Exchange.

You can buy and sell the SPY (just like any other stock listed in the US) through a Singapore broker. However, using a Singapore broker, you will not be able to buy it intraday and will have to pay hefty commission charges. A much cheaper and more flexible approach would be to open an online US brokerage account to trade.

Chart 13: Five-Year Performance of the SPDR (Symbol: SPY)

Ever since the financial crisis unfolded in October 2008, the SPY is down 50% from its high of about $152 to a low of $75.30 and is currently at $85.27 as at 2 December 2008. Again, another great long-term investment opportunity here, but is it time to enter? Find out in the later part of the chapter.

3) DIAMONDS, Series 1 (Ticker Symbol: DIA)

If you want to track the Dow Jones Industrials Index instead, you can buy the DIAMONDS, Series 1 (ticker symbol: DIA). The DIA is an ETF that tracks the Dow Jones Industrial Index. It is constructed in a very similar way to the SPY.

Minimum size to buy: 1 Share

Pricing: Approximately 1/100 of the Dow Jones. For example, if the Dow is at 9,000 points each unit of DIA would be US$90.

Operating Expenses: 0.1% Annually

Dividends: The DIA price reflects its share of dividends accrued in the Trust.

Buying and Selling: The DIA is listed on the American Stock Exchange. You can buy and sell the DIA (just like any other stock listed in the US) through a Singapore broker. However, using a Singapore broker, you will not be able to buy it intraday and will have to pay hefty commission charges. A much cheaper and more flexible approach would be to open an online US brokerage account to trade.

Chart 14: Five-Year Performance of the DIAMONDS, Series 1 (Symbol: DIA)

Similarly, the DIA is down 45% from its high of about $137 to a low of $76.

Buy the S&P 500 or the Dow Jones Index?

A common question people ask is, which is the better investment over the long term - the S&P 500 or the Dow Jones? To answer that, let's compare the price chart of the S&P 500 and the Dow Jones over the last 50 years.

Chart 15: Comparing the S&P 500 to the Dow Jones Index

The S&P 500 Index is represented by the black line and the Dow Jones by the green line. As they visually indicate, the S&P 500 gives relatively higher returns than the Dow Jones, but is a lot more volatile in the process. So if you can stomach greater ups and downs in the shorter term, the S&P 500 offers higher potential returns over time.

4) iShares FTSE/ Xinhua China 25 Index (Ticker Symbol: FXI)

We cannot discuss investing in markets without mentioning China – one of the fastest and largest growing economies. The iShares FTSE/Xinhua China 25 Index ETF (FXI) is the most traded China-focused ETF today. Ever since the financial crisis erupted on October 2008 and fears of a US recession became reality, the Chinese economy has suffered a major slowdown in exports, which led the FXI to plunge 73% from its highs to its lowest point. Its current price-to-

earnings ratio of 11 as at 31 Oct 2008 (you will learn more about PE ratios later) and its dividend yield rate of 4% make it an attractive value investment.

The FXI seeks investment results that generally correspond to the price and yield performance of the FTSE/Xinhua China 25 Index. This index is designed to represent the performance of the 25 largest companies in the Chinese equity market that are available to international investors. Many of these companies are also SOEs (state-owned enterprises) and are listed on the Hong Kong Stock Exchange.

Minimum size to buy: 1 Share

Pricing: As of 2 December 2008, each FXI share is $26.41.

Operating Expenses: 0.74% Annually

Dividends: The FXI pays cash dividends. Its current dividend yield is 4%.

Buying and Selling: The FXI is listed on the New York Stock Exchange. You can buy and sell the FXI (just like any other stock listed in the US) through a Singapore broker. However, you will not be able to buy it intraday and will have to pay hefty commission charges. A much cheaper and more flexible approach would be to open an online US brokerage account and trade from it.

Chart 16: Five-year Performance of the iShares FTSE/Xinhua China 25 Index (Symbol: FXI)

The FXI has fallen from its high of $70+ to where it now stands at $26.41 (as at 2 December 2008). Again, it is a great long-term investment opportunity if you believe in the future growth prospects of China. Let's find out later when the best time to get in is.

5) iShares MSCI Emerging Market Index (Ticker Symbol: EEM)

Stock markets of developing countries also present a great investment opportunity, especially after the ripple effects from the plunge in the US markets. The markets of Indonesia, India, China and Korea have fallen sharply lower in the last 12 months.

Once thought decoupled from the US economy and hence 'immune' to the crisis, emerging markets are now bearing the brunt of the global financial turmoil with the slump in their stock markets.

Western investors and hedge funds have dumped anything considered risky, almost regardless of local fundamentals. Below are some facts about recent emerging market falls.

Emerging Stock Markets

Globally, emerging stock markets have lost 60% of their value since May, down to their lowest in four years and losing 38% in October alone.

Russia's stock market has been one of the biggest hit. It plunged 75% in 2008 as war with Georgia, concerns over government interference in investments and bank worries sent capital fleeing. Among other key emerging markets, Brazilian stocks have lost as much as 47%, Chinese stocks 70% the same year and Indian stocks down by 57%.

An ETF that tracks the top companies of the fastest growing emerging markets is the MSCI Emerging Markets Index ETF. This ETF is made up of 552 stocks from emerging market country indices like China, India, Russia, South Korea, Poland, Indonesia, Chile, Brazil and Argentina.

Minimum size to buy: 1 Share

Pricing: As of 2 December 2008, each EEM share is $22.05. The annualized return since inception is 23.13% (as of 30 Sept 2008).

Operating Expenses: 0.74% Annually

Dividends: The EEM pays cash dividends. Its current dividend yield is 4.2%.

Buying and Selling: The EEM is listed on the New York Stock Exchange. You can buy and sell the EEM (just like any other stock listed in the US) through a Singapore broker. However, this method will not allow you to trade intraday, and attracts hefty commission charges. A much cheaper and more flexible approach would be to open an online US brokerage account.

Chart 17: Five-Year Performance of the iShares MSCI Emerging Markets Index (Symbol: EEM)

The EEM has fallen from its high of $54 set in October 2007 to $22.05 (as of 2 December 2008).

6) iShares MSCI United Kingdom Index (Ticker Symbol: EWU)

As the financial crisis spreads across Europe, the UK property market has accelerated its decline, while its

banks stand on shaky ground. This has sent the FTSE 100 (Financial Times Stock Index, representing the London Stock Exchange) down more than 40% from its highs.

To take advantage of this crash to make money when it eventually recovers, I would buy the EWU. The EWU is an ETF that tracks the MSCI United Kingdom index, which captures 85% of the total capitalization of the British Stock Market.

Minimum size to buy: 1 Share

Pricing: As of 2 December 2008, each EWU share is $11.81. The annualized return for the last 5 years is 7.82% (as of 30 Sept 2008).

Operating Expenses: 0.51% Annually

Dividends: The EWU pays cash dividends.

Buying and Selling: The EWU is listed on the New York Stock Exchange. You can buy and sell the EWU (just like any other stock listed in the US) through a Singapore broker. However, this method will not allow you to trade intraday, and attracts hefty commission charges. A much cheaper and more flexible approach would be to open an online US brokerage account.

Chart 18: Five-Year Performance of the MSCI UK Index ETF (Symbol: EWU)

The UK market has declined from $25+ to a low of $10.60 over 13 months. That is a 58% plunge from its highs!

The Trend is Your Friend

Before deciding when it is a good time to buy into an index, you must first learn about the psychology of investors. This is reflected in stock price movement patterns. The study of these patterns is known as technical analysis.

Stock prices tend to move in general directions known as trends. The three main trends are an (a) uptrend, (b) downtrend and (c) consolidation.

Although the stock market moves upwards in the long term, along the way there are downtrends and uptrends over a shorter-term period.

Once a stock/index is moving in particular direction (trend), it will tend to stay in that trend until there is a major reversal of investor psychology. For example, when a stock/index is in an uptrend, it means investor sentiment towards that stock/index is very optimistic. This bullish attitude fuels more buying, which pushes the stock price higher.

From October 2004-October 2007, the S&P 500 Index went on an Uptrend

Chart 19: S&P 500 Index on an Uptrend

Unless there is major negative news, the stock will keep moving higher. A trend is like an ocean current that moves in a direction until a major force (e.g. weather change) affects the direction.

If there is sudden market-related bad news (i.e. the financial crisis), there will be a reversal in investors' psychology – from optimistic to pessimistic – and the stock/index will go on a downtrend.

After October 2007, the S&P 500 Reversed into a Downtrend

Chart 20: S&P 500 Index on a Downtrend

(a) The Uptrend

Check out a typical uptrend below, and you'll notice how the stock price moves up and down within a 'channel'. Each new price drop generally ends above the level of the previous drop. Each new low is higher than the previous low.

Chart 21: Uptrend

Every time the stock price drops to a certain level, investors will think that it has gotten too cheap. This sparks a buying interest that pushes the stock price upwards again. This becomes somewhat of a psychological point that the stock is unable to break below, known as the SUPPORT LINE. In other words, it is a psychological price level that 'supports' the stock price.

Similarly, the moment the stock price has risen to a certain level, investors believe that it has become overpriced and overbought. They then start to sell to take profits. This selling pressure pushes the stock price down again. This price level that the stock price keeps below is known as the RESISTANCE LINE.

(b) The Downtrend

Chart 22: Downtrend

Likewise when the stock/index is in a downtrend, the price moves up and down within a downward

channel. There is a psychological resistance line that prevents the price from going higher, and a support line that stops the price from plunging too fast.

(c) The Consolidation

Sometimes stock prices move in a sideways direction. This is known as a consolidation period. Again, stock prices still go and down, however they stay above the support line and below the resistance lines.

Chart 23: Consolidation

Now that you understand the patterns in which stock prices move in and how support and resistance lines play apart, let's explore the different strategies you can use to make money buying the market.

4

Buying Markets & Sectors in Crisis Part 2

Buying Markets & Sectors in Crisis Part 2

Buying Strategy: When Do I Buy?

Strategy #1: Just Buy and Hold

The simplest strategy is to simply buy the index ETF as soon as possible and hold it for the long term. Remember that the longer you invest, the lower the risk. At the same time, you always make money if you hold long enough (over 5-10 years).

At the same time, the earlier you start buying and the longer you stay invested, the greater your money will compound and grow. From studying past data, we know that the US Market (S&P 500 Index) has achieved an annual compounding return of 12.08% (with dividends reinvested) over the long term.

So you can aim to achieve an average annual return of 12.08% on your invested money if you stay invested over the long-term.

The Power of 12.08% Can Make You into an Automatic Millionaire

Although a 12.08% return may not seem very exciting, it can make you very rich as long as you stay invested over the long term.

Consider this: an average salaried person earns about $1 million in his/her lifetime.

How do we get this figure? The average person makes about $36,000 a year ($3,000 per month). He/she is usually employed from age 25 till age 60, working a total of 35 years.

In this case, the average person will earn a total of $36,000 x 35 = $1.26 million in his/her lifetime. The same probably applies to you, but unfortunately does not make you a millionaire. The problem is that for most people, they will only see a fraction of that $1,260,000, after deducting all expenditures and bad investments.

However, imagine if you were to just save 10% of your income and use the savings to invest in the S&P 500 Index ETF. In other words, you invest $3,600 a year and let it compound at 12.08% for 35 years.

If you were to do just this alone, you would see a total of $1.77 million SAVINGS at the end of 35 years! Think about that! Just by investing 10% of your annual income at an annual return of 12.08%, you would get more than 100% of your entire income.

I know that you may be thinking to yourself that you DO NOT have 35 years left to become rich or that you do not want to wait 5-10 years in order to start achieving positive returns.

Well, you don't have to. The simple strategy illustrated earlier assumes that you have zero knowledge of

investing. A 12.08% return is the minimum return you should aim for, if you are not thinking of applying any strategy at all.

However, using more sophisticated plans in the pages to come, you will find that you can actually achieve a much higher rate of return (15-17%) within a much shorter period of time.

Tips to Ensure that You Do Not Invest at Market Tops

One important thing to note about the 'Just Buy and Hold' strategy to maximize its effectiveness is to ensure that you DO NOT buy when the market is too expensive. Remember that every time the market goes up, it will first dip slightly (before going up again).

So if you buy during times when the market was too high (e.g. like in 1972, 2000 and 2007), you would have seen the value of your investments drop BEFORE seeing them eventually breaking even, and then making a profit after some time. I do not know about you, but I do not want to go through all that unnecessary trouble.

For example, if you had bought into the market at the beginning of 1973 (the market top, point A), you would need to have waited eight years to break even on your investment and another few more years to achieve that 12.08% annual return.

Chart 24: S&P 500 Index 1970-1983

However, by entering the market near the middle or even better, near the bottom of the market, you would have made high returns in a few months. For example, if had started investing in the middle of 1974, you would have made a positive return in less than a year.

Ensuring you Invest Near the Bottom & Never Near the Top

Here are two major things to look out for to ensure that you invest near the bottom instead of the top:

Indicator #1: Avoid Investing when there is Great Economic News; invest when there is Major Bad Economic News.

Whenever you read the newspapers or watch the news, you might catch headlines about how the economy is growing rapidly, or that markets are making new highs. Watch out! These are usually signs

that the market is nearing the top, and a big drop is about to happen.

These are a sample of the Business News headlines in Late 1999-Early 2000 (Just Before the Dot Com Crash)

- Nasdaq, S&P Hit New Highs. Dow Up 3, *23 Dec 1999*
- Stocks Soar in Santa Claus Rally. , *24 Dec 1999*
- London, Paris Stocks Reach Record Highs, *25 Dec 1999*
- Four Indices Hit Highs on Tech Stock Gains, *30 Dec 1999*
- Rational Exuberance for Greenspan: Fed Chief Praised for Policies During Boom, *5 Jan 2000*
- Economic News Sends Stock Prices Higher, *2 Jun 2000*
- Tech Stock Rally Buoys Investors. Nasdaq Notches Best 1-Week Gain Ever, *2 Jun 2000*

A few months after these news headlines came out, the stock market crashed, sending prices down 36% over the next two years.

These were the Business News Headlines in Early 2007 (Just Before the Financial Crash in October 2007),

- Dow Closes Above 14,000; Earnings Reports, Mergers Sustain Long Market Rally, *20 Jul 2007*

- Job Growth Strengthens Economy; Spending and Hiring Rise While Inflation Eases, *2 Jun 2007*

- S&P 500, Dow Hit Record Closes As Investors' Rate Fears Ease, *31 May 2007*

- S&P 500 Tops 1500 On Strong Earnings; Index Approaches Its All-Time High, *4 May 2007*

- ECONOMY Manufacturing Grows ..., *2 May 2007*

- Rise in Factory Orders Propels Dow to New High, *3 May 2007*

Guess what happened within three months of all this great news? The stock market crashed by more than 47% in one of the worst financial crises since the Great Depression.

The lesson: Be wary when you see words like 'Economic Growth', 'New Highs', 'Market Rally' or 'Boom', and when everyone is highly optimistic about the stock market. It is usually followed by a market crash.

When the News is Bad, it is Time to Buy!

On the other hand, when the news is constantly about how the economy is going to be/or is in a recession,

and there is panic selling or major losses in the markets, it is a sign that markets are near or at a bottom.

These were the News Headlines in 1974, just BEFORE the Bull Run in Sept 2007 that lifted the Dow from 64 points to 329 points, a 514+% Gain for the Next 13 years.

- Economy in Recession, Citibank Report Says, *23 Jul 1974*

- Financial Leaders Feel Anxiety About Future of Economy, *4 Aug 1974*

- Dow Jones Average Hits 12-Year Low, *28 Sep 1974*

- 68% See Economy Worsening, *29 Sep 1974*

These were the News Headlines in late 2002- early 2003, just BEFORE the bull run that would have netted investors 300+% returns for the next six years.

- U.S. Retail Sales Fell 1.2% in September; More Indications of a Slowing Economy, *12 Oct 2002.*

- Fed Gets Gloomier On State of Economy; Activity Sluggish, Survey Discovers, *24 Oct 2002*

- A Dismal 2002 Ends Quietly on Wall Street; Dow's Percentage Loss Biggest Since '77, *1 Jan 2003*

- Dow Retreats Below 8000; War, Other Fears Spur 'Bearish Sentiment', *28 Jan 2003*

Lesson: When words like 'panic', 'crisis', 'recession', 'worst loss' make up the financial headlines, it is usually an indication that the market is undervalued or near a bottom. This is the best time to accumulate stocks just before the next bull market takes off.

As I write this book in November 2008, these are the major news headlines:

- USA TODAY survey: We're in recession, economists say, *28 April 2008*

- Bernanke Warns Of 'Grave Threat' To U.S. Economy; Fed Chairman Pushes Bailout, Citing Worsening Credit Market, *25 Sep 2008*

- Worst Crisis Since '30s, With No End Yet in Sight, *18 Sept 2008*

- Dow Slices Through 9,000 as Investors Panic, *9 Oct 2008*

- NewsDaily: Recession fear plunders Wall Street, Dow dives 678.91, *9 Oct 2008*

- Slowdown Fears Spark Market Slide, *7 November 2008*

- US Jobless Rate Hits 14 Year High, *10 November 2008*

So, do the clues from history tell you whether we are

at a market top or somewhere near the bottom? Is it a good time to start investing?

Indicator #2:
Invest only when PE Ratios are Below 15-20.

Besides just reading financial news headlines, another indicator of market tops and bottoms is to look at the market's Price-to-Earnings Ratio (PE Ratio).

What does it tell you? It gives an idea of how much the market is willing to pay for the company's earnings. The higher the PE ratio, the more the market is willing to pay for the stock. However, if it is excessively high, some investors may also see the stock as overvalued. Conversely, a stock with a low PE ratio usually means investors have little confidence in it, or that it could be a gem that the market has overlooked.

To calculate the PE ratio of a company's stock, you would take the current share price and divide it by the Earnings Per Share (based on the last financial year).

$$\text{Price-to-Earnings (PE) Ratio} = \frac{\text{Current Share Price}}{\text{Earnings Per Share}}$$

For example, General Electric (GE) earnings per share is $2.10 and its last share price was $20.40. So the PE ratio of GE is $20.40/ $2.10 = 9.7 times.

This means that for every $1 that each share of stock earns, investors are willing to pay 9.7 times for it. So, is this expensive or cheap?

Historically, index stocks are priced at between 15-20 times earnings. In other words, the average PE ratios of stocks are 15-20x. During times of crisis and recession, investors become very pessimistic and are less willing to pay as much for a stock. During such times, PE ratios are lower (less than 15 times). Investing during these periods is safer because stock prices tend to be near the bottom.

During bullish times of economic growth, investors become highly optimistic about future earnings and are willing to pay a lot more for their stocks. During such times, PE ratios become very high (more than 20 times). This is usually an indication that the stock market is overpriced and ready for a correction.

For example, just before the dot com bubble burst in 2001, PE ratios of stocks were between 30-40 times! Stocks of technology companies (like Yahoo!) were more than 300 times! Sure enough, these high stock prices were not sustainable and the market came crashing down till PE ratios got to below 20 times again.

Before buying an index ETF, first check the PE ratio of the ETF. This can be usually found on the fund factsheet from the fund manager's website. Let's take a look at the various index ETFs discussed earlier.

The SPDR, Series 1 (Ticker Symbol: SPY)

From the screen capture below, we can see that the SPY has a PE ratio of 10.45, which is again below the

historical PE ratios. You can get the latest update from www.ssgafunds.com

Screen Capture from ssgafunds.com

Fund Characteristics	
As of 11/07/2008	
Dividend Yield	2.96%
FY1 P/E Ratio	10.45
Number of Holdings	502
Price/Book Ratio	1.76
Weighted Average Market Cap $M	$77,216.63

iShares FTSE/Xinhua China 25 Index (Ticker Symbol: FXI)

Screen Capture from iShares.com

As we can see from above, the FXI has a current PE Ratio of 11.37 as at 7 Nov 2008. This means it is slightly undervalued based on historical PE ratios.

The Straits Times Index ETF (STI ETF)

Unfortunately, there is nowhere you can find the PE ratio of the Straits Times Index ETF. However, you can get a rough feel of the PE ratio of the STI by looking at the PE ratio of the 30 component stocks (as of 15 November 2008).

Chart: STI Constituents and their PE Ratios

CapitaLand	2.56	Jardine Matheson Holdings	5.80	SIA Engineering	8.32
CapitaMall Trust	4.18	Jardine Strategic Holdings	5.03	Singapore Airlines	6.03
City Developments	6.12	Keppel Corp	5.40	Singapore Exchange	10.57
Cosco Corp Singapore	5.39	Keppel Land	1.25	Singapore Press Holdings	12.77
DBS Group Holdings	6.08	Neptune Orient Lines	1.84	ST Engineering	13.46
Fraser & Neave	8.77	Noble Group	7.55	SingTel	10.05
Genting International Plc	na	Olam International	9.14	Starhub	10.40
Golden Agri-Resources	1.16	Oversea-Chinese Banking Corp	7.32	United Overseas Bank	8.67
Hong Kong Land Holdings	1.85	Sembcorp Industries	7.39	Wilmar Intl.	18.92
Jardine Cycle & Carriage	6.61	Sembcorp Marine	6.86	Yanlord Land Group	5.21

Strategy #2: Dollar Cost Averaging

The second strategy, 'Dollar Cost Averaging' is also a very simple strategy to execute and one that would achieve relatively higher returns than Strategy #1 (Buy and Hold).

This strategy does not bother with timing the bottom of the market, but guarantees that you never buy the market at a high average price. This way, you will definitely be able to make consistent returns within a shorter period of time.

The idea is to consistently invest a FIXED DOLLAR AMOUNT of money into the index ETF at regular periods of time (e.g. twice a year).

For example, you decide to invest $1,000 every six months into the stock market. Referring to the chart below…

When the index price is $10,
your $1,000 will buy you 100 shares

When the index price is $50,
your $1,000 will buy you 20 shares

When the index price is $20,
your $1,000 will buy you 50 shares

When the index price is $100,
your $1,000 will buy you 10 shares

When the index price is $50,
your $1,000 will buy you 20 shares

When the index price is $200,
your $1,000 will buy you 5 shares

When the index price is $100,
your $1,000 will buy you 10 shares

By doing this, you'll realize that when the stock prices are high, you automatically buy LESS shares. When stock prices are low, you automatically buy MORE shares. This way, you are assured that the average price you pay is a lower average, ensuring faster and higher profits over time.

In this case, let's calculate what your average price will be.

Total amount invested = $1,000 x 7 = $7,000
Total number of shares bought = 215
Average price per share = $32.56!

By using the strategy, you will easily make a profit once the stock market rises above this low average price!

Strategy #3: Timing the Market Using Technical Analysis

By timing the market, our third strategy will generate you the highest returns over the shortest period of time. However, it is a strategy that would be the most challenging to execute, as it would involve the understanding of technical analysis studies and a little homework.

The idea is to buy at the beginning/middle of an uptrend and sell at the beginning of a downtrend. Re-enter the market again after it has bottomed and started a new uptrend.

Chart 25: S&P 500 Index 1997-2008

As you can see from the above chart, it is almost impossible to predict and buy at the bottom and sell

at the very top. The very best we might achieve is to buy somewhere near the bottom (after an uptrend has been confirmed) and sell after it has reached the top and has started to come down.

Here are the basics rules to do this:

a) Buy on a Dip in an Uptrend

The safest time to buy is when the stock price goes through a dip on an uptrend. There is an old Wall Street saying that goes 'the trend is your friend'. Remember that when a stock/index is in a trend, it will tend to move on that general direction until a major event causes a reversal.

Also, remember that within an uptrend, the prices still move up and down. Logically, it would make sense to buy just after a dip (downwards movement), so that you can you can ride the next upward movement. However, it is always safer to wait till after the index price has successfully hit and then moved up away from the support line to confirm that the trend is still intact (see point B).

Buying in just before the stock price has bounced up from the resistance line (See point A) may get you a cheaper price but there is a risk that the price may break below the support line and reverse into a downtrend.

Chart 26: Buying during a Dip on an Uptrend

b) Sell when an Uptrend Reverses into a Downtrend

In strategy #1 (Buy and Hold), we would have happily held onto the ETF through its uptrends and downtrends, then finally selling it after a long period of time. This would give us a historical annual compounded return of 12.08%.

With this strategy #3 (Timing), we aim to sell our ETF shares once the market has become overpriced and has reversed into a downtrend. How do we tell when this is happening? Here are some indications.

Indication #1: The stock/index price breaks BELOW the long-term support line.

Once the stock/index price breaks below the support line, it is an indication that the trend may have ended and a reversal into a downtrend may begin. This is a time when it may be prudent to start selling part of your index ETF shares.

Chart 27 Selling on a Downtrend

Indication #2: The stock/index price breaks BELOW the moving average.

Moving averages are very strong indicators of support and resistance. They are one of the most popular and easy to use tools in technical analysis. They work by smoothening a series of "volatile bumpy data" into a nice smooth line to make it easier to spot trends. As a medium-long term investors, it is important to look at the 20, 50 and 200-day moving averages.

Moving averages (MA) are calculated by taking the average of the closing price of the stock/index for a particular period of time. For example, the 20-day moving average is calculated by taking the average of the closing price of the stock/ETF for the last 20 days. This average is then plotted on the chart to present the 20-day MA.

Usually when the price of a stock/ETF is ABOVE the MAs, it is a healthy sign that the stock/ETF will continue to move higher.

However, once a stock/ETF price breaks below a MA, it is a signal that the stock/ETF has weakened and may start to move down.

So the moment the ETF price breaks below the 20 and 50 day moving average, it is a clear indication that **a downtrend has begun** and it will be prudent to sell all off your shares and lock in your profits.

c) Avoid Buying on a Downtrend; Buy After a Reversal

It is wise to avoid buying in at any time when the Index ETF is experiencing a downtrend. Again, as long as it is on a downtrend, there is a high chance that it will keep moving down.

One of the most common mistakes investors make is buying during a rally on a downtrend (see chart 28). When stocks make a gain because of some good news, investors think that the stocks are ready to move up. After buying in, they then find that the price plunges to a further low.

You only want to start buying in when the market has hit a real bottom and a reversal has been **confirmed.** It is almost impossible to buy at the exact bottom, but it is pretty good enough to buy somewhere near that, just before the next bull run.

Chart 28: Danger of Buying a Rally on a Downtrend

Here are some indications that confirm a reversal:

a) Major price gain in any of the major indexes (S&P 500, Dow Jones or Nasdaq 100), accompanied with high volume

The first indication if a possible reversal in trend is when one of the major indices makes a gain of 3% or more in a single day with above average volume of shares traded. This indicates that many large institutional investors have begun entering the market again.

b) The stock/ETF price breaks above the resistance line

The second factor necessary is that the stock/ETF price must break above the resistance line with above average volume.

c) The stock/ETF price breaks above the key Moving Averages

Thirdly, wait until the index ETF breaks above at least one of the moving averages (200 day, 50 day or 20 day). Breaking above a moving average is a powerful indicator of upward momentum.

d) A new uptrend is confirmed

Finally, wait for a new uptrend to be confirmed. The stock should take at least 2-3 bounces on the resistance line of a new uptrend channel (instead of breaking below it).

Again, the best time to buy back into the market is when the price takes a dip on this new uptrend.

While this third strategy of timing your entry and exit points may take a lot more study and effort, you reap what you sow. It generates you much higher returns (possibly 15-17% annually), by doing away with the unprofitable holding on of stock through periods when the market is moving down or going sideways.

Investing in Sectors

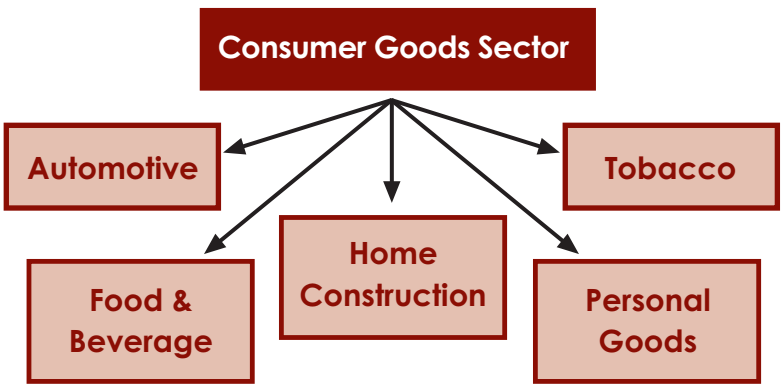
Besides buying the index ETF that tracks the entire market, you can achieve even better returns by targeting specific sectors and industries within the market.

Every stock market is made up of thousands of stocks that can be categorized into broad sectors. Companies are grouped into the sectors

according to their products or services. For example, the US market can be divided into 10 broad sectors that include:

- Financial
- Health Care
- Energy
- Technology
- Consumer Goods
- Consumer Services
- Materials
- Industrials
- Utilities
- Telecommunications

At the same time, each sector can be further broken down into industries that are themselves made up of smaller business groups. For example, the 'Consumer Goods' Sector is made up of the following industry groups: 'Automotive industry', ' Food & Beverage industry', 'Personal Goods industry', 'Home Construction industry', 'Tobacco Industry' and etc.



This is important to understand because different sectors & industries offer investment opportunities at different points in time. Targeting to invest in specific sectors/industries can yield you much higher returns than just investing in the broad market.

Sector Rotation

Due to changes in interest rates and economic activity, money flows into certain sectors and out of others at different times

Obviously, when money flows into a particular sector, the prices of all the stocks in that sector will get a boost. Meanwhile the stocks in other sectors experiencing an outflow of money will see their prices slump. To take advantage of sectors that are on an uptrend, you can buy the index ETF of that sector.

Buying Sectors on an Uptrend

Should you sit on your spare cash amid the recession-related gloom?

There are actually still investment opportunities, because not all sectors are equally affected. In fact, some may be bucking the overall trend.

There are certain sectors that continue to move upwards while the broader market index moves downwards. These are known as defensive sectors. They are deemed recession-proof sectors, as they can still make money during a downturn.

As you can see from the chart below, the US market (represented by the S&P 500 Index) was on a downtrend from Aug 2007 to Aug 2008 after the financial crisis had erupted. However, Oil and Gold were on a steady uptrend as the rest of the market was going down. In times of economic uncertainty, money tends to flow out of equity markets and into bonds, treasuries and commodities.

From August 2007 to August 2008, the S&P 500 was on a Downtrend

Chart 29: S&P500 Index Aug 2007 – Aug 2008

From August 2007 to August 2008, Gold (represented by the SPDR Gold Trust ETF, Symbol: GLD) was on an Uptrend

Chart 30: SPDR Gold Trust ETF Aug 2007-Aug 2008

From August 2007 to August 2008, Oil Prices (represented by the US Oil Fund LP ETF, Symbol: USO) was on an uptrend.

Chart 31: US Oil Fund LP ETF Aug 2007-Aug 2008

So, even as the overall market was going down, you could have still made profits by buying the SPDR Gold Trust ETF (ticker symbol: GLD) and the US Oil Fund LP ETF (ticker symbol: USO).

Profiting from Sectors in Crisis

Now that the entire market has fallen over 47% from its highs in October 2007, you can potentially make a lot of money over the next few years by buying the S&P 500 Index ETF or the Dow Jones Index ETF.

Similarly with the expected rebound, you can get even higher returns targeting specific sectors that are severely undervalued, with the highest potential for growth.

At the same time, certain sectors will recover much faster than others. By investing in sectors that will recover first, you can potentially achieve profits faster than if you were to just invest in the broad market index.

You can 'buy an entire sector' by buying the sector index ETFs. Here are the common sector ETFs offered by the Select Sector SPDRs family (www.sectorspdr.com);

- Consumer Discretionary Sector SPDR Fund (symbol: XLY)
- Consumer Staples Sector SPDR Fund (symbol: XLP)
- Energy Sector SPDR Fund (symbol: XLE)
- Financial Sector SPDR Fund (symbol: XLF)
- Health Care Sector SPDR Fund (symbol: XLV)
- Industrial Sector SPDR Fund (symbol: XLI)
- Materials Sector SPDR Fund (symbol: XLB)
- Technology Sector SPDR Fund (symbol: XLK)
- Utilities Sector SPDR Fund (symbol: XLU)

Which Sectors Are the Most Undervalued?

At first glance, it may seem that the financial sector is the most undervalued with the highest potential for growth. After all, this sector is down more than 63% from its index ETF high price of $36.34.

The hidden truth is that the financial sector is NOT the most undervalued. That's because of the negative earnings of financial companies (hit by subprime writedowns).

From the chart below, you can see that the most undervalued sectors are the Energy Sector (Forward PE of 6.6) and Industrials Sector (Forward PE of 9.8).

Extract from www.sectorspdr.com
> Sector Valuation Report

Chart 32: Ratios of the Sector SPDRS (As of 11 Nov 2008)

P/Es	S&P 500		
	2007A	2008E	2009E
Consumer Discretionary	19.5	18.4	12.4
Consumer Staples	19.2	14.5	13.2
Energy	13.0	6.6	6.6
Financials	17.2	NM	9.8
Health Care	17.6	12.1	10.6
Industrials	16.6	9.8	9.6
Information Technology	23.7	12.6	11.1
Materials	16.3	9.5	9.6
Telecommunication Services	20.4	11.8	10.3
Utilities	18.5	11.6	10.6
S&P Indexes	**17.8**	**12.8**	**10.0**
S&P/Citigroup Growth	17.9	10.7	9.8
S&P/Citigroup Value	17.7	16.5	10.1

STARS, Yields and PEGs	S&P 500		
	STARS	Yield	PEG
Consumer Discretionary	3.5	2.6%	1.0
Consumer Staples	4.3	3.0%	1.3
Energy	4.4	2.1%	0.6
Financials	3.6	4.4%	1.0
Health Care	3.9	2.5%	1.0
Industrials	3.6	3.6%	0.8
Information Technology	3.8	1.3%	0.8
Materials	3.5	3.7%	0.7
Telecommunication Services	4.6	5.8%	1.5
Utilities	3.6	4.5%	1.4
S&P Indexes	**3.9**	**2.9%**	**0.9**

An even more accurate way of telling if a sector is undervalued or overvalued is to look at the PEG Ratio. The PEG Ratio is the ratio of the PE Ratio to the Earnings Growth Rate of the stock/ETF.

In general, an ETF with a PEG Ratio below 1 is considered undervalued and a PEG Ratio above 1 is considered overvalued. Using the chart above, you can see that 'Energy', 'Industrials' and 'Materials' have the lowest PEG ratios and provide the best buys right now.

Which Sectors Will Recover First?

Historically, the Financials and Industrial sectors tend to be the first ones to stage a rebound. However, the best way to be sure is to watch the price charts of each one of the nine sector SPDR ETFs.

Look out for the first few sector ETFs that reverse the downtrend into a new uptrend. These are the ones you should invest in for the ride up. If you recall, a reversal is confirmed when its price breaks above the

downtrend resistance line and breaks above the 20 and 50-day moving average.

Create a Diversified and Balanced Portfolio

While index ETFs are relatively safer to invest in than individual stocks, it is always important not to put all your eggs in one basket. You should diversify your money across a few index ETFs.

Although the financial crisis has its origins in the US, it is the Asian markets that have been hit harder. While the US index plunged to a low of 47% from its peak, the China Index plummeted 70% and the Singapore Index by 61%.

Keeping in mind the potential of markets to recover, there is possibly more upside for Asian indices. Another point to note is that history has shown (as examined in chapter two) that the Singapore stock market actually rebounds faster than the US market.

The gyrations of the Singapore market are more prominent due to its relative smaller size to the US. The impact of every transaction is magnified. So conversely, it usually dips faster than the US market as well.

Remember all this as start your research to build a portfolio of index and sector ETFs.

5

Finding Great Value Stocks Amidst the Chaos, Part 1

Finding Great Value Stocks Amidst the Chaos, Part 1

In the last chapter, you learned how to take advantage of ETFs to buy sector and market indices that have plummeted.

In this chapter, you are going find out how to pick out the individual stocks that will be the first to take off and outperform the market when it recovers.

Remember that when the stock market recovers, not all stocks will rebound with it. Stocks of fundamentally weak companies may be so badly affected by the crisis, they may go bust or never see their stock prices ever returning to old times. For example, don't expect global insurance giant AIG, which is now trading at $2-$3, to ever recover to its days of $70-$80. These are stocks that you must learn to avoid!

On the same principle, the stocks of fundamentally strong companies will not only recover but will go on to record new highs when the market turns around. These are companies that have not been fundamentally affected by the crisis. Instead, their prices are artificially low because of extreme pessimism in the market. Their stocks were heavily dumped along with others by investors more out of fear than any other reason. Remember that when the market is bearish, all stocks get sold - the good with the bad.

When the market regains its optimism and becomes bullish again, it is the good stocks that will fly back to where they were and beyond and the bad stocks are the ones who will stay where they are. The trick is to of course identify the good stocks from the bad ones. This is exactly what you are going to learn in this chapter.

The Gurus all made their Fortunes in Market Crises

There's a small secret behind how many of the world's investing gurus made their billions. A lot of their profits came from buying stocks of fundamentally sound companies during past market crashes. A big bargain when prices were artificially driven down by extreme sentiment.

Sir John Templeton (one of the world's greatest stock pickers) made billions of dollars by buying up shares of great companies selling at less than US$1 during the Great Depression (when no one else dared to buy!). He later saw his wealth multiply a hundredfold in just four years as the market turned around. His famous quote – "invest at the point of maximum pessimism".

Warren Buffet, currently the world's richest man and revered for being the world's greatest investor, made over US$60 billion purely from just investing in the stock market. Buffett made his greatest buys during the oil shock of 1973-1974 and the dot com crash of 2001-2003.

Amid the 1973 crisis, he saw many valuable companies selling at a fraction of their worth and remarked, "I feel like an over-sexed man in a harem". He happily embarked on a shopping spree and bought millions of dollars worth of undervalued stocks, later turning them into billions of dollars in profits. His famous quote – "be fearful when others are greedy; be greedy when others are fearful".

The Investing Philosophy of the World's Greatest Investors

As you may have realized, all of the most successful (and richest) stock market investors adopt a contrarian approach. Instead of following the crowd, they do the opposite! They stand by the sidelines watching the rest busy themselves with buying during optimistic times, and step in for the bargains when the market sentiment reverses.

We all agree that the best time to go shopping would be when everything is on sale. But ironically, what we are seeing in the real world is instead quite the opposite. If we likened the stock market to a supermarket, we would be seeing customers rushing out the door when prices drop, and back in again when prices are high! It is this herd mentality that causes most investors to buy high and sell low, eventually leading them to lose money in the long run.

To be among the minority who make consistent profits from the stock market, it would be logical to go against

the herd mentality. It makes sense to start buying when everyone is selling (when prices are low) and vice versa (when prices are high).

The Three Steps in Value Investing

What do you need to know to be part of the profit making minority? Well, there are three major steps to becoming a successful value investor:

Step 1: Identify very good businesses
Step 2: Buy their stocks at a bargain price
Step 3: Wait for the market to realize the stock's true value

Step 1: Identify Very Good Businesses

The first thing to understand when buying a stock - you are not purchasing a lottery ticket with a random chance of its price moving up or down. Buying a stock means that you are buying part ownership of a company that is listed on a stock exchange.

For you to make money, you have to only buy VERY GOOD businesses. It should have a solid business model that brings in earnings (sometimes termed as profits) that are CONSISTENT and PREDICTABLE. Ultimately, it is a company's ability to generate higher profits every time that will drive up its value and consequently its share price.

Many businesses are able to earn high profits from time to time. However, their profits are usually inconsistent and usually decline in the face of new

competition or when demand for their goods and services decline. These are companies that you want to avoid buying!

Very few companies (less than 5%) can make CONSISTENT and PREDICTABLE earnings over the long term. These good businesses are the only ones that you should invest in.

So, what qualities will allow a company to achieve such a feat? To be able to achieve CONSISTENT earnings over time, the company has to possess a 'sustainable competitive advantage' (also known as an economic moat) that protects it from any competition. If it can be insulated from the threat of competitors either undercutting prices or stealing market share, the business will be able to safely increase its sales and profits over time. You will find out how to identify these good businesses in the later part of this chapter.

Predictable is good, it means safe. How can we be sure that the future of the company will not change for the worse? We can learn a lesson from legendary investor Warren Buffett, who believes that the most predictable businesses are the ones that sell a simple product that never becomes obsolete.

Let's take a look at some cases. Microsoft may be currently making huge profits because of its dominance in software. Apple may make double-digit profit growth because of hit products like the

iPhone and Mac computers. However, there is no way to predict that they will continue to enjoy their dominance 10-20 years from now! It's not hard to imagine how all this could come to an end. For example, Google has been pushing the front on free computing through online and open-source software. If the idea takes off, the software market pie would be greatly reduced!

Buffett views such technology companies as too difficult to predict and too risky to invest in. We cannot be sure that customers will continue using the iPhone, or Microsoft software 10-20 years from now.

Instead, Buffett prefers to buy companies that sell products that will never become obsolete. These include Coca-Cola (Coke & other soft drinks), Nike (sports apparel), Hershey's (chocolates), Burlington North Santa Fe (railroad), United Health (healthcare services) and Kraft Foods (packaged food products). The reason why he chose such companies? It is hard to imagine life without them. For example, people have been drinking Coke for over a century, and it is highly likely that people will still be drinking it at least in the next decade or so.

Very good businesses also share another trademark – they are so financially strong that they can survive and prosper, despite a recession or a financial setback. Remember that ALL businesses will go through recessions and financial problems from time to time. The financially weaker ones (with too much debt and

too little cash) will go bust. On the other hand, the financially stronger ones (low debt and lots of cash) will not only survive, but emerge even stronger thanks to the crisis crippling its weaker competitors.

For example, American Express was hit by a scandal in 1963 and faced a US$60 million loss, effectively its entire net worth. Its share price tanked 50%, and Buffett bought as many shares as he could. Why did he pour all that money into a company in that situation? He knew that the company had the financial strength to recover and coupled with its fundamentals become stronger over time. He was right and eventually sold his shares for a US$20 million profit.

In the later part of this chapter, you are going to learn a step-by-step process of selecting such companies that achieve consistent and predictable earnings growth and also have the financial muscle to emerge stronger from this crisis (and any future crisis for that matter).

Step 2: Buy Their Stocks at Huge Price Discounts

Once you have identified a great business, the second step is to buy its stock only when prices are way below their true value (known as intrinsic value). For example, if a company like PepsiCo (NYSE: PEP) is worth $74, you would buy it when the stock price is trading at a good discount like $55. Eventually, the market would push its stock price back to or above its intrinsic value of $74.

In the later part of the chapter, I am going to show you how to calculate the intrinsic value of a company, based on its financial performance.

If a Stock is Worth $74, Why is it Selling at $55?

Many people often wonder, 'if it is such a great company with such consistent earnings growth, then why would it be selling for a price that is below its true value?'

The answer is because the stock market is irrational in the short-term. That's because it attracts millions of investors – most not trained in finance – whom make decisions based more on speculation than financial logic.

In the short term, stock prices fluctuate because they are driven by the market forces of demand and supply. When people are rushing to buy a stock, demand exceeds supply, which causes the price to shoot up. There have been many cases when stocks deemed worthless (e.g. the company was losing money) but its price keep shooting higher. That's simply because of the speculative greed by people creating a huge demand for the stock (gambling on its rise, and hopping on the bandwagon).

This is what happened during the dot com bubble when the greed of ignorant investors caused them to buy millions of internet stocks that were worthless. Sure enough the stock prices shot up by a few hundred

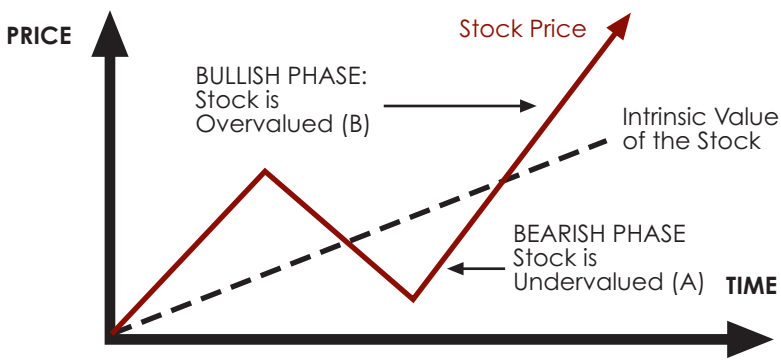
per cent. Eventually, when the market became rational over time (also called a correction), many stock prices plunged to near zero and these ignorant investors lost their life-savings.

Similarly, when people are rushing to sell stocks during times of fear (like now!), supply will exceed demand and stock prices will fall! Again, there are many cases when a company's stock is valued highly (e.g. $74), but suffers from a price plunge (e.g. to $55 or below) simply because fearful sentiment made them sell at ridiculously low prices.

Knowing a Stock's True Worth

This is where trained - rational - investors like you and me can make heaps of money. By knowing the true worth of a stock, we can take advantage of people's fear and ignorance and pick up great stocks at huge discounts.

Since stock markets are driven by the emotions of fear and greed, they tend to overreact to bad news and overreact to good news. Take a look at the chart below as I illustrate what I mean.



The black dashed line represents the intrinsic value of a good company. Over time, as the company makes consistently increasing profits, its intrinsic value will move higher. However, its stock price will not always move in tandem with its value.

Its stock price (represented by the red line) swings below and above its value as the stock market goes through a bullish phase (times of optimism) and a bearish phase (times of pessimism). When there is bad news in the market (e.g. recession fears, threats of war and etc), the market tends to overreact out of fear and sends prices way below the intrinsic value. This is the point when the stock becomes undervalued (point A).

When there is good news in the market (eg. high economic growth, consumer spending increases and etc), the market again eventually overreacts out of greed and sends stock prices rocketing way above their true values. This is when stocks become overvalued (point B).

As a value investor, we want to buy companies when the market is bearish and when the stock prices are way undervalued.

Step 3: Wait for the Market to Realize the Stock's True Value

Finally, great investors know that fortunes are not made overnight. They have the confidence and patience to wait until the market recovers, before taking profits when things get too bullish and stock prices become way overpriced.

Many people have the misconception that the world's best investors are able to predict the market and somehow time their investments. The truth is that NOBODY can time the market consistently and accurately. Great investors like Warren Buffett, Peter Lynch, Benjamin Graham and John Templeton never made their billions by buying exactly at the bottom. They merely bought somewhere NEAR the bottom - good enough for them and anyone else.

They have NO IDEA WHEN the market will turn or where the market will go in the next few months or even the next few years. All they know is that if they are patient enough, the market will turn bullish ONE DAY.

Here's a quote by Warren Buffett during a speech he gave to an MBA class in the University of Florida (May 2007), "I have no idea where the market going to go. I never did and never will. It's not something I think about at all".

So, in this book, I am not going to make a prediction as to when the market will turn around. It may be anywhere from one month to a year or even longer. If the best investors in the world don't bother with predicting the market, I am not going to pretend that I can.

The 8 Steps of Buying Great Companies at Huge Discounts

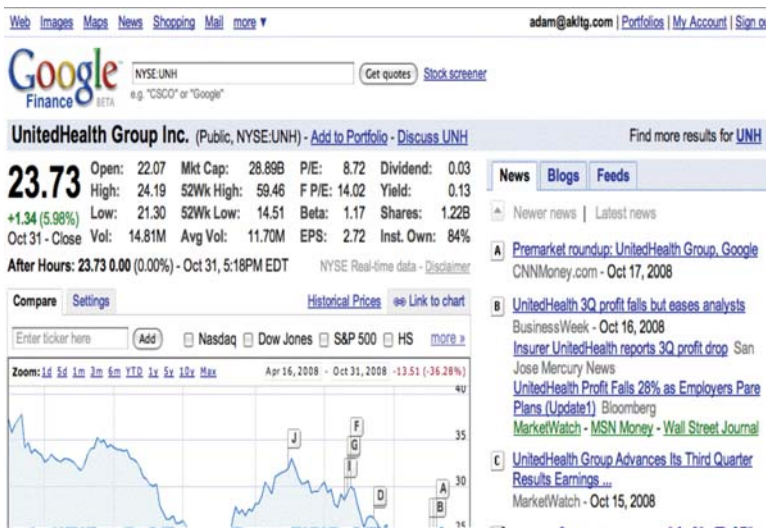
In order to identify great businesses and buy them at

discounts to their intrinsic value, there are eight steps in the screening process. Let's take United Health (NYSE: UNH) as a case study.

Even before you attempt to screen a company, it is very important to first read up thoroughly on the company's products, business model, recent news and financial history to understand the business. The most important factor of all is to invest only in businesses that you understand.

If you don't understand how the company makes money, do not invest in it. It is a rule that Buffett lives by. He only believes in investing in one's circle of competence. You can read up more on a company by visiting finance.google.com and doing a search on the company. From there, it will point you to the company's website and investor relations information.

Screen Capture from http:// finance.google.com



Understanding UnitedHealth Group Inc's (UNH) Business

UnitedHealth Group Incorporated (UnitedHealth Group) is a diversified health and well-being company, serving approximately 70 million Americans. The Company provides individuals with access to healthcare services and resources through more than 560,000 physicians and other healthcare providers and 4,800 hospitals across the United States.

UnitedHealth Group conducts its operations through four operating divisions: Health Care Services, OptumHealth, Ingenix and Prescription Solutions. You can find out more from the company's website at www.unitedhealthgroup.com. UNH is also owned by Warren Buffet through his company Berkshire Hathaway Inc. He started accumulating shares as early as 2006.

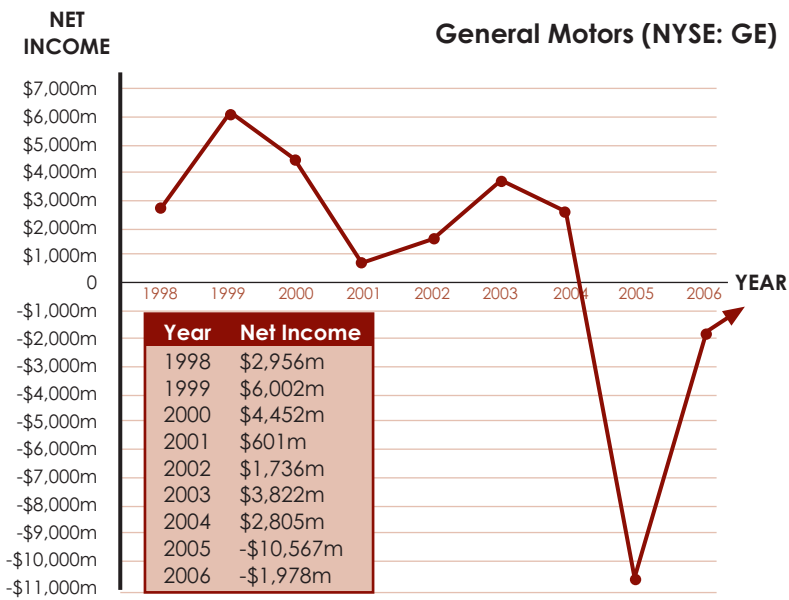
Overview of the Eight Criteria for Value Investing

Step 1: History of Consistent Earnings & Cash Flow Growth

Recall that a great business is one that is able to achieve consistent and predictable earnings growth over the long term. Only when earnings growth is predictable, then can you accurately make an assessment of the company's current value.

Part of the data to calculate this comes taking a look at the history of the company's earnings growth. You should only want to buy a company if it has a track record of being able to increase its earnings consistently for at least seven years. The cash flow generated from the company's business operations should also be increasing consistently.

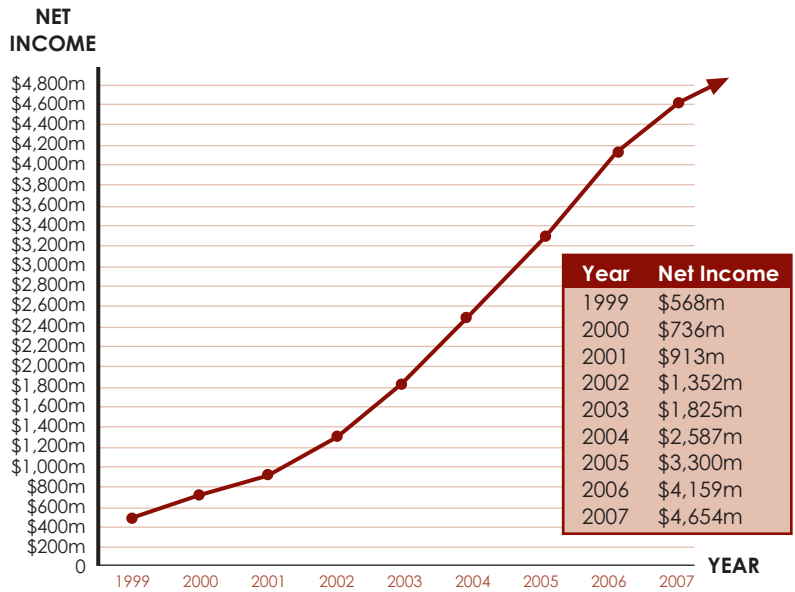
General Motors is an Example of a Business with Inconsistent & Unpredictable Earnings



Year	Net Income
1998	$2,956m
1999	$6,002m
2000	$4,452m
2001	$601m
2002	$1,736m
2003	$3,822m
2004	$2,805m
2005	-$10,567m
2006	-$1,978m

Nike, Inc is an Example of a Business with Consistent & Predictable Earnings

In this case, UNH definitely passes this first criterion.



Step 2: Sustainable Competitive Advantage (Economic Moat)

Just because a company has been able to successfully grow its earnings in the past, does not mean that it will able to do so in the future.

The main obstacle that would disrupt earnings growth is competition. As a company grows in sales and profits, it may attract competitors that will slash prices in order to take away market share.

In order to protect it from competitive threats and assure a future stream of profit growth, the company you invest in must have a sustainable competitive advantage. This refers to a special edge that a company has over its competitors, which cannot be easily replicated. It provides a significant barrier to competition from other firms.

Such a competitive edge is also popularly known as an economic moat. This is derived from the concept that it is the obstacle that prevents a fortress from being penetrated by competitors.

For example, what allows the Coca-Cola Company to continuously sell more bottles of coke every year and at the same time consistently increase its profits over the last 116 years? What has prevented competitors from offering cheaper and better soft drinks and taking away their customers and profits?

In fact, many others competitors such as RC Cola, Virgin Cola and Pepsi Cola have spent millions of

dollars in advertising without putting so much as a dent in Coca-Cola's profits. What gives Coke its economic moat is its BRAND NAME and its SPECIAL FORMULA. Other companies that possess an economic moat from its strong brand name include Nike, McDonalds, IBM, Caterpillar and Visa.

Brand name is not the only thing that gives a company an economic moat. Think of some Singapore companies like Singapore Press Holdings (STI: SPH), Singapore Exchange (STI: SGX) or SMRT. Will they have any trouble from competition? No way! Their competitive advantage comes from their MONOPOLY status.

Strong market leadership and huge economies of scale also give companies a wide economic moat. It is almost impossible for competitors to fight with companies like GE, Wal-Mart, Google, Amazon or Microsoft.

In summary, a company's economic moat can come from:

a. A Strong Brand
   (eg. Coca-Cola, Nike, PepsiCo, Exxon Mobil, McDonald's, Visa, Google, Singapore Airlines, Asia Pacific Breweries which owns Anchor, Tiger)

b. Patents and trade secrets
   (eg. Pharmaceutical companies like Pfizer, and Merck)

c. Gigantic Economies of Scale
(eg. GE, Wal-Mart Stores, Amazon.com, Google)
d. Market leadership that competitors will find very difficult to overtake in the next decade
(eg. General Electric, Visa, eBay, Google, CapitaLand
e. High switching costs that lock in customers
(eg. Adobe, Stryker, Microsoft)
f. Monopoly status
(eg. Singapore Press Holdings, Singapore Exchange, SMRT)

As you can see, some companies have economic moats in more than one area.

When you invest in a company that has a strong, sustainable competitive advantage that protects it from competitors and allows it to retain and build its customer base, you can predict with certainty that earnings and stock value will continue to increase.

In this case, UNH definitely has a sustainable competitive advantage
(economic moat).

UNH's economic moat comes from:

a) The Network Effect
UnitedHealth connects its 70 million customers to a network of healthcare providers, which includes

560,000 physicians and 4,800 hospitals in the US. The firm reaps the benefits of the Network Effect that results when customers seek out UnitedHealth for access to so many care providers and providers join the UnitedHealth network for access to all those customers.

b) Huge Economies of Scale
As the market leader, UNH's huge size gives the company immense Economies of Scale advantages. UnitedHealth is able to spread out administrative costs and fixed investments in technology over more customers, lowering per-customer costs as compared to any of its competitors. It is therefore able to pass on these discounted prices to its customers.

Step 3: Conservative Debt Financing
It is normal and healthy for a company to borrow money to grow its operations. However, borrowing too much makes a company financially unstable.

In time of economic recession and market downturns, companies that take on too much debt may find themselves being forced into bankruptcy. Companies like AIG and Lehman brothers may have had a wide economic moat and a history of consistent profits. However, that did not save them AIG from near bankruptcy and Lehman from going bust during the financial crisis. They had taken on too much debt and were unable to make good. Steel maker FerroChina is a good example of an Asian company that had

great growth prospects and a strong business model, but it got into financial trouble because it was too heavily geared in the short term. This left it with severe cash flow problems.

It is therefore especially important to ensure that the company you are investing in has no debt or has conservative debt. An indication of this would be to ensure that the company's LONG TERM DEBT is less than three times its ANNUAL NET INCOME. For example, if the company is making a net profit of $1 million a year, it should have long-term debt of no more than $3 million.

In the case of UNH, a look at its annual report will show you that Net Income (2007) is $4,654 million and Long-Term Debt (2007) is $9,063 million.

Since its Long Term Debt is definitely less than three times of Net Income, it has very conservative debt financing.

Step 4: High Return on Equity (ROE)

The next criterion is a high Return on Equity (ROE). ROE is a measure of a company's profitability that reveals how much profit it generates with shareholders' money.

$$\text{Return on Equity (ROE)} = \frac{\text{Net Profit After Tax}}{\text{Shareholder's Equity}}$$

The ROE of most listed companies is an average of 12. So, a business that has an ROE above 12-15 is highly profitable and a great investment. A business with an ROE below 12 is considered a lousy investment.

In the case of UNH, a look at its annual report will show you that its ROE is definitely above 15%.

ROE (2005) = 32.65%
ROE (2006) = 21.58%
ROE (2007) = 22.77%

Step 5: High Free Cash Flow

Excellent businesses also have a high level of free cash flow. When a company is cash rich, it can easily recover from financial setbacks. It has the resources to invest in future growth or the option of paying out dividends. Here is how you calculate it:

Free Cash Flow =
Cash Flow from Operations - Capital Expenditure

As a benchmark, companies are considered cash rich when their Free Cash Flow / Sales Revenue are greater than 5%. You can find this figure easily in the company's annual report.

In the case of UNH, a look at its annual report will show you that it is very cash rich.

Year	2005	2006	2007
Free Cash Flow/ Sales Revenue	8.41%	8.1%	6.64%

Step 6: Management is Holding/Buying Stock

The next criterion is to look at the insider trades of the major shareholders and senior management of the business. If you wanted to buy the stock of AIG and found that its CEO, CFO and senior directors were all selling shares aggressively, common sense would tell you that you may be making a wrong decision. If the company's own directors don't have faith in their own shares, then how can you?

On the other hand, if you found that the CEO, CFO or senior directors were aggressively buying up shares of their own company, it would give you a greater confidence in your decision. Remember that directors buy up shares for only one reason. They want to be richer and believe their stock is undervalued and has upward potential.

So, only buy a company's stock if the senior management of the company is holding or buying up its own shares. If senior management is selling a large quantity of shares, then you should be wary of proceeding with your purchase.

"Insiders might sell their shares for many reasons, but they buy for only one: they think the price will rise"

- Peter Lynch

I find that the best place to find this information (for US stocks) is to go to www.form4oracle.com. Here is a screen capture as at 2 November 2008 of the insider trades of UNH.

Last 50 Transactions

SEC Filing	Insider	Track Record	Trade Date	Transaction	Total	% Holdings	Return
24-Oct-08 5:09 PM View:	Sweere Lori EVP, Human Capital	-39% (1 decision)	24-Oct-08	Market Purchase (1,250 @ $22.05)	$27,558.00	3%	8% (< 1mo)
20-Oct-08 5:22 PM View:	Hemsley Stephen J President & Chief Exec Officer Director	--	17-Oct-08	Option Exercise (150,000 @ $8.72)	$1,307,819.94	62%	--
17-Sep-08 9:19 AM View:	Hemsley Stephen J President & Chief Exec Officer Director	--	16-Sep-08	Option Exercise (215,000 @ $8.72)	$1,874,541.91	758%	--
15-Sep-08 5:00 PM View:	Burke Richard T Director	0% (22 decisions)	12-Sep-08	Market Sale (6,000 @ $29.30)	$175,800.00	< 1%	41% (1mo)
15-Sep-08 5:00 PM View:	Burke Richard T Director	0% (22 decisions)	11-Sep-08	Market Sale (75,000 @ $29.44)	$2,207,827.52	3%	41% (1mo)
26-Aug-08 9:31 PM View:	Mikan George Lawrence ... Exec VP & CFO	--	22-Aug-08	Option Exercise (100,000 @ $16.53)	$1,653,199.96	217%	--

If the company you are researching on passes the first six criteria, it means that it is a very good business. The next two steps are to confirm if the business is now selling at the right price.

In the case of UNH, a look at from4oracle shows that there is neither heavy accumulation of shares or heavy selling of shares by the management. So, this criterion is a low pass.

Step 7: Stock Price is Safely Below Intrinsic Value

One of the most crucial steps is to determine the intrinsic value of the company's shares and to ensure that the current share price is way below this fair value. So how do we calculate a stock's fair value?

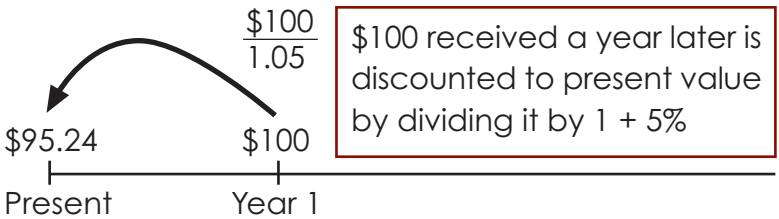
Let me explain using an example (readers of 'Secrets of Millionaire Investors' will find this familiar).

Ask yourself this question, 'What is the most you would pay for a machine that would generate $100 today?' The answer is $100! If you paid $100 for a machine and it generates back $100, you would break even. So, that is what the most you would pay.

Now, what is the most you would pay for a machine that will generate $100 in one year? Would you pay $100? Of course not. You would definitely pay less than $100, as you would have to wait a year to get your money back. So, what is the maximum you should pay for that deal? The answer depends on the risk-free interest rate, which is usually measured by three-month US Treasury Bills.

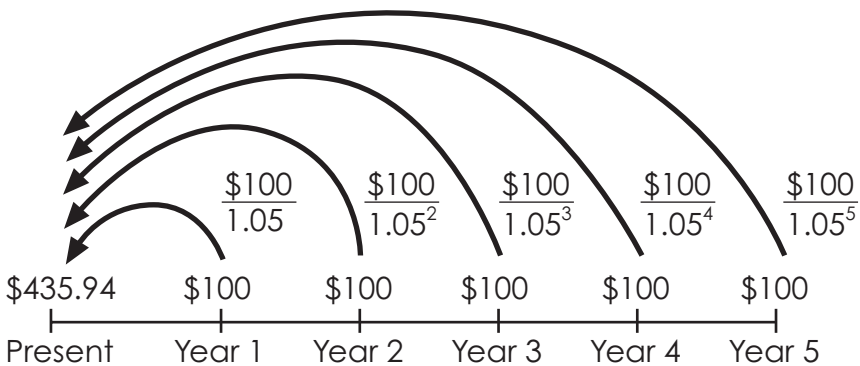
If the risk-free rate is 5%, you would pay a maximum of $95.24 ($100/ (1+ 0.05)) for the machine today. Why? Well, if you were to put that $95.24 in a risk free investment earning 5%, you could get $100 a year later.

So, $95.24 is the present value you would place on $100 to be received a year later. In other words, **money received in the future is worth less today.** To find out the present value of $100 received in one year, we divide it by 1+0.05 (risk free rate) to get $95.24. This is known as discounting future value to present value.



$100 received one year later is worth $95.24 today.

Now, how much would you pay for a machine that will generate $100 in one year, $100 in the second year, $100 in the third year and so on till the fifth year? To find the answer, you would have to discount each future payment to its present value.



$100 received in year 1 will be worth $100/1.05
= $95.24 today

$100 received in year 2 will be worth $100/$1.05^2$
= $90.70 today

$100 received in year 3 will be worth $100/$1.05^3$
= $86.38 today

$100 received in year 4 will be worth $100/$1.05^4$
= $82.27 today

$100 received in year 5 will be worth $100/$1.05^5$
= $78.35 today

So, the present value of the entire five payments would be worth $435.94 today ($95.24 + $90.70 + $86.38 + $82.27 + $78.35). The value of the machine will be worth a maximum of $435.94 today.

Similarly when you buy a stock, you are buying part of a company that would generate cash every year, year after year. A company is nothing but a money-making machine. Therefore…

The Intrinsic Value of a stock is equal to the Present Value of All its Future Cash Flow from Operations.

In theory, the intrinsic value of a company is calculated by adding up all its future operating cash flow to perpetuity and then discounting it to the present value. However in reality, companies do not last forever. To be very conservative, assume that the company will only last for ten more years. So, we will calculate the intrinsic value of a stock by adding up all the projected cash flow from operations over the next ten years and discounting it to the present value.

Calculating the Intrinsic Value of UnitedHealth Group

Let's look at a concrete example of how you could calculate the intrinsic value of UNH.
Refer to Table 1 Below.

Here are some key facts about UNH:

- Cash flow from Operations 2007 is $5,877 million
- Total Shares Outstanding is 1,297 million shares

a) Projecting Operational Cash Flow for the Next 10 Years (CF Proj)

The tricky part is estimate the cash flow growth rate of the company for the next 10 years. This is done by studying the company's growth plans for the next 5-10 years. How many more stores are targeted to open? What are the new markets to be tapped? What new products are expected roll out next?

All this work is usually done by hundreds of stock analysts who will come to a consensus on the projected growth rate of the company's earnings and cash flow. You can get an estimate of this figure by going to www.moneycentral.com and clicking on 'Earnings Estimates'

Screen Capture from www.moneycentral.com

Earnings Growth Rates	Last 5 Years	FY 2008	FY 2009	Next 5 Years
Company	+26.10%	-15.20%	+3.30%	+11.70%
Industry	+25.60%	+0.20%	+13.80%	+13.50%
S&P 500	+11.80%	+5.70%	+7.50%	NA

In this case, UNH's projected cash flow growth rate is 11.7% over the next five years beyond 2009. For simplicity, we will assume that UNH will experience an annual earnings growth rate of 10% for the next 10 years. We will use earnings growth rate as a proxy to its cash flow growth rate.

Since the cash flow from operations is $5,877 million in 2007, we can project that it will be $6,464.7 million in 2008, $7,111 million in 2009, $7,822 million in 2010 and so on (just increase it by 10% each year). This can be seen in Table 1 under Cash Flow (Projected).

b) Calculating a Discount factor (DF)

Now, remember that money received in the future is worth less today. So, we have to discount all future cash flow by a discount factor. Taking a very conservative risk free rate of 5%, the discount factors (DF) are derived by dividing 1 by 1.05n, where 'n' is the number of years to be discounted. Thus the discount factors you see in Table 1 below are 0.95 (1 1.05), 0.91 (11.052), 0.86 (11.053) and so on.

c) Discounting all Future Cash Flows to Present Value (DV)

The 'Discounted Value' of all the future cash flows (DV) is derived from multiplying the projected cash flow with the discount factor (DV = Cash Flow (Projected) x Discount Factor). From Table 1, you can see that the discounted values (DV) of all the future cash flow are worth $7,284m, $7,651m, $8,037m, $8,443m and so on.

Table 1: Calculating Intrinsic Value for UNH

Name of Stock	UnitedHealth Group
Stock Symbol	UNH
Operating Cash Flow (current)	$5,877.00 millions
Cash flow growth rate	10.00%
No. of Shares Outstanding	1,297.0 millions

PV of 10 yr Cash flows	$76,585 million
Intrinsic Value per share	$59.05

Current Year	2007	NB: Take the last Fiscal Year as the Curren
Discount Rate	5%	NB: Use the 3 months US Treasury Rate

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Cash Flow (Projected)	$6,464.70	$7,111.17	$7,822.29	$8,604.52	$9,464.97	$10,411.46	$11,452.61	$12,597.87	$13,857.66	$15,243.42
Discount Factor	0.95	0.91	0.86	0.82	0.78	0.75	0.71	0.68	0.64	0.61
Discounted Value	$6,156.86	$6,450.04	$6,757.19	$7,078.96	$7,416.05	$7,769.19	$8,139.16	$8,526.74	$8,932.77	$9,358.14

Note: This assumes EPS growth rate remains constant throughout the 10 years
In certain cases, you may want to lower or increase the growth rate after a few years.

The intrinsic value of the whole company (i.e. UNH) would be the sum of all the future 'Discounted Cash Flow' for the next 10 years

= Add up all the Discounted Values
= $6,156.86 m+$6,450.04m+$6,757.19m+...+$9,358.14m
= $76,585 million (PV of 10yr Cash Flows)

Now that we know how much the whole company is worth, how much is one share of stock worth?

To get the intrinsic value of **one stock**, take $76,585 million and divide it by the total number of shares outstanding (i.e. 1,297 million shares).

So, the **intrinsic value of one stock** = $\frac{\textbf{\$76,585 million}}{\textbf{1,297 million}}$
= **$59.05 per share**

As of 2 December 2008, UNH's share price is $20.32. At this price, the stock is more than 60% undervalued.

Step 8: Stock Price is on an Uptrend

Finally, it is always safer to buy a stock when the stock price is either (a) on an uptrend or (b) breaking out of consolidation (i.e. moving sideways). Remember from the previous chapter that 'the trend is your friend'. When the stock price is on a downtrend, it is always best to avoid jumping in until it has reversed into an uptrend and has broken above its 50-day and subsequently 20-day moving averages.

(a) Buy when it Dips on an Uptrend
Remember that the safest time to buy is when the stock price takes a dip, but stays above the support line of the upward trending channel.

b) Buy when Stock Breaks Out of Consolidation at High Volume

Another entry point is when the stock price breaks out from the resistance line during a consolidation phase. It is also important that during the breakout, volume traded is higher than average.

> * Note that value investors like Warren Buffett, Peter Lynch and John Templeton don't bother timing the market by reading stock charts. They buy purely on fundamentals. Instead of timing when the stock price will move upwards, they start buying once the stock is undervalued. They are prepared to hold on for years until they make a profit.

Let's take a look at the price chart of UNH.

Chart 33: 5-Year Price Chart of UNH

From the 5-year price chart, you can see that UNH share price has been on a downtrend since Jan 2008. It has plunged from $64 to a low of $17+, settling at $20.84 as of 14 Nov 2008.

Chart 34: 6-Month Price Chart of UNH

A closer look at the 6-month price chart reveals that UNH has been on a downtrend below the 20-day and 50-day moving average. A good entry point would be to wait for the share price to break above the moving averages with above average volume, and when it goes through a dip on a new uptrend.

6

Finding Great Value Stocks Amidst the Chaos, Part 2

Finding Great Value Stocks Amidst the Chaos, Part 2

Let's now look at an example of how to put a Singapore-listed company through the eight step screening process. To illustrate this, we will use Singapore Exchange Limited (SGX).

Again, the first thing you need to do is to go to the company's website (you can Google this easily), download the annual report and understand the business thoroughly.

Understanding Singapore Exchange Limited's (SGX) Business

Singapore Exchange Limited (SGX) is Singapore's only and Asia's first demutualised and integrated securities and derivatives exchange.

SGX provides integrated clearing and settlement services, as well as central depository facilities. SGX offers a suite of securities and derivatives products via a global network of broking members.

SGX's securities products, traded on an electronic screen-based system include business trusts, equities, exchange traded funds (ETFs), global depository receipts (GDRs), infrastructure funds, real estate investment trusts (REITs), warrants, and bonds, debentures and loan stocks.

Foreign companies from over 20 countries, some from as far as Europe and North America, are listed on SGX; they make up over one-third of those listed.

SGX is an international exchange and listing hub representing a full spectrum of industries.

Step 1: History of Consistent Earnings & Cash Flow Growth

By going to www.sgx.com and searching for Singapore Exchange Limited's (SGX) annual reports, you will be able to track the company's sales revenue, earnings and cash flow over the last 5-7 years.

Alternatively, use a shortcut by going to www.shareinvestor.com (a paid site) and look under 'financials'.

Screen Capture from www.shareinvestor.com

HISTORICAL FUNDAMENTAL DATA

PROFIT & LOSS (SGD '000)

Next Page

Period	Full Year Jun 2008	Full Year Jun 2007	Full Year Jun 2006	Full Year Jun 2005
Revenue	768,579	576,223	407,560	274,714
Exceptional Items (eg. Discontinued Operations)	-	-	-	-
Share Of Profit of Associates	(622)	(2,494)	(949)	(27)
Profit Before Tax (Include Exceptional Items)	575,526	490,340	236,130	139,697
Profit After Tax	478,320	421,777	187,614	109,455
Minority Interests	-	-	-	7
Net Earnings	478,320	421,777	187,614	109,462

A quick glance will show you that earnings have been increasing consistently from 2005-2008.

Step 2: Sustainable Competitive Advantage (Economic Moat)

In this case, SGX definitely has a sustainable competitive advantage (wide economic moat). SGX's economic moat comes from its monopoly as the only stock exchange in Singapore. It is also Asia's first and one of its largest demutualised and integrated securities and derivatives exchange.

Step 3: Conservative Debt

A look at SGX's annual report will show you that Net Income (2008) is $478.320 million and there is no Long-Term Debt (2008). There is no debt financing. This fits alright into the criteria.

Step 4: High Return on Equity (ROE)

Recall that the company you invest in should have a Return on Equity (ROE) above 12-15%. Again, you can find this figure from the company's annual report or from www.shareinvestor.com.

Screen Capture from www.shareinvestor.com

Period	Full Year Jun 2008	Full Year Jun 2007	Full Year Jun 2006	Full Year Jun 2005
Return On Equity (ROE) (Net Earnings/Equity)	53.507 %	50.794 %	31.969 %	23.066 %

In the case of SGX, its high ROE of 53.507% in 2008 definitely passes this criterion.

Step 5: High Free Cash Flow

The fifth step is to ensure that the company you are investing in has a high level of free cash flow. Recall

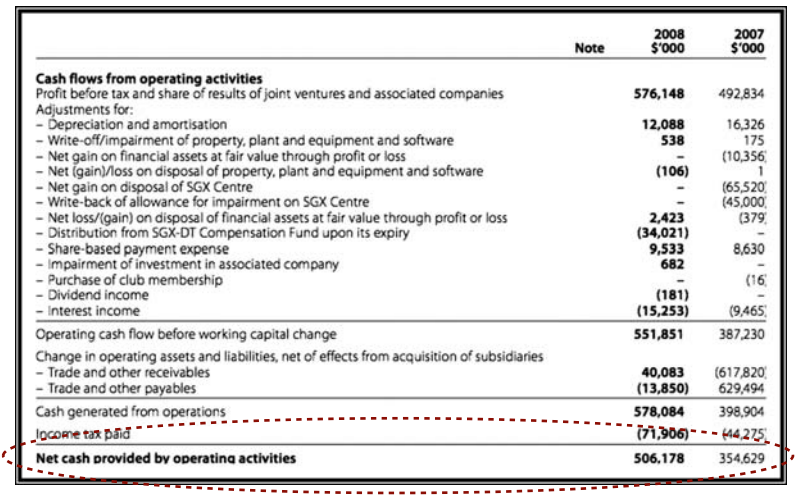
that Free Cash Flow = Cash Flow from Operations – Capital Expenditure.

A ratio of Free Cash Flow/ Sales Revenue above 5% is considered a great investment.

From the annual report of SGX in 2008:

- Cash Flow from Operations = $506.178m
- Capital Expenditure = $45.786m
- Free Cash Flow = $506.178m - $45.786m = $460.392m
- Sales Revenue = $768.579m

Screen Captures from SGX Annual Report 2008



	Note	2008 $'000	2007 $'000
Cash flows from operating activities			
Profit before tax and share of results of joint ventures and associated companies		**576,148**	492,834
Adjustments for:			
– Depreciation and amortisation		**12,088**	16,326
– Write-off/impairment of property, plant and equipment and software		**538**	175
– Net gain on financial assets at fair value through profit or loss		**–**	(10,356)
– Net (gain)/loss on disposal of property, plant and equipment and software		**(106)**	1
– Net gain on disposal of SGX Centre		**–**	(65,520)
– Write-back of allowance for impairment on SGX Centre		**–**	(45,000)
– Net loss/(gain) on disposal of financial assets at fair value through profit or loss		**2,423**	(379)
– Distribution from SGX-DT Compensation Fund upon its expiry		**(34,021)**	–
– Share-based payment expense		**9,533**	8,630
– Impairment of investment in associated company		**682**	–
– Purchase of club membership		**–**	(16)
– Dividend income		**(181)**	–
– Interest income		**(15,253)**	(9,465)
Operating cash flow before working capital change		**551,851**	387,230
Change in operating assets and liabilities, net of effects from acquisition of subsidiaries			
– Trade and other receivables		**40,083**	(617,820)
– Trade and other payables		**(13,850)**	629,494
Cash generated from operations		**578,084**	398,904
Income tax paid		**(71,906)**	(44,275)
Net cash provided by operating activities		**506,178**	354,629

Cash flows from investing activities		
Proceeds from disposal of property, plant and equipment and software	**165**	1
Purchases of property, plant and equipment and software	**(45,786)**	(14,498)
Net proceeds on disposal of SGX Centre	**–**	266,269
Dividend received	**181**	–
Interest received	**14,421**	9,382
Investment in financial assets, available-for-sale	**(1,144)**	(75,812)

	Note	The Group 2008 $'000	2007 $'000
Operating revenue			
Securities clearing fees		**301,240**	220,860
Securities related processing fees		**68,104**	47,886
Access fees		**80,261**	57,248
Net derivatives clearing revenue		**156,305**	116,979
Account maintenance and corporate action fees		**41,910**	35,252
Terminal and connection fees		**22,578**	17,659
Listing fees		**41,587**	31,511
Membership fees		**9,411**	6,993
Price information fees		**28,846**	23,014
Sale of software and other computer services		**11,021**	10,069
Management fees from subsidiaries		–	–
Dividends from subsidiaries		–	–
Others		**7,316**	8,752
Total operating revenue		**768,579**	576,223

So Free Cash Flow/ Sales Revenue = $460.392m/ $768.579m = 59.9%. This is way above the 5% mark.

Step 6: Management is Holding/Buying Stock

The next step is to ensure that management is either holding or buying up the company's shares. You can easily check this figure by going to www.sgx.com and clicking on 'listed company-general announcements'. Look under 'Notice of Interest/Change in Interest'. A faster way would be to go to shareinvestor.com (paid site) and look under 'insider trades'.

Screen Capture from Shareinvestor.com

Announce Date	Date of Effective Change	Buyer/Seller Name	Type*	S/W/U **	Bought/(Sold)('000)	Price($)	After Trade		Note
							No. of Shares ('000)***	% Held***	
02/09/08	02/09/08	SGX	COY	S	170	6.090-6.240	NA	NA	-
01/09/08	01/09/08	SGX	COY	S	180	6.170-6.290	NA	NA	-
28/08/08	28/08/08	SGX	COY	S	170	6.090-6.160	NA	NA	-
26/08/08	26/08/08	SGX	COY	S	80	5.970-5.990	NA	NA	-
25/08/08	25/08/08	SGX	COY	S	120	6.120-6.260	NA	NA	-
22/08/08	21/08/08	Hsieh Fu Hua	DIR	S	500	1.700	3,910	0.37	Note
21/08/08	21/08/08	SGX	COY	S	210	6.180-6.250	NA	NA	-
20/08/08	20/08/08	SGX	COY	S	100	6.220-6.270	NA	NA	-

You can see from the above that the company and one of its directors have been aggressively been buying back stock in the $6.00+ range.

Step 7: Stock Price is Safely Below Intrinsic Value

The next step is to find out how much SGX stock is really worth. We need to calculate the stock's intrinsic value.

It is only a good investment when the stock price is trading way below the intrinsic value, thus giving you a margin of safety. I only buy when the stock price is at least 25% below intrinsic value.

Here are some key facts about Singapore Exchange Limited (SGX):

- Cash flow from Operations 2007 is $492.834 million
- Total Shares Outstanding is 1068.722 million shares

a) Projecting Operational Cash Flow for the Next 10 Years (CF Proj)

For Singapore (even Asian) listed stocks, there isn't readily available information on projected earnings/cash flow growth rate. The best we can do is to make an educated, conservative guess from its historical cash flow growth rate.

From the annual reports, we can see SGX's historical operating cash flow:

2008	$506.178m
2007	$354.629m
2006	$227.205m

2005	$100.787m
2004	$189.0m
2003	$56.0m
2002	$79.0m

Using a financial calculator, you can determine that the annual compounding cash flow growth rate (2002-2008) is 36.28% per year. In other words, SGX has been able to grow its operating cash flow at an annual rate of 36.28% for the last seven years.

It will however, be too optimistic to project that cash flow will continue to grow at 36.28% for the next 10 years. To be highly conservative, I am going to assume that cash flow will grow at a rate of just 15% for the next 10 years. (*15% is the average earnings growth rate of most listed companies)

Since SGX's cash flow from operations is $506.178m in 2008, we can project that it will be $582.1m in 2009, $669.42m in 2010, $769.83m in 2011 and so on (just increase it by 15% each year). This can be seen in Table 2 under **Cash Flow (Projected).**

b) Calculating a Discount Factor (DF)
Now, remember that money received in the future is worth less today. So, we have to discount all future cash flow by a discount factor. Taking a very conservative risk free rate of 5%, the discount factors (DF) are derived by dividing 1 by 1.05n, where 'n' is the number of years to be discounted. Thus the discount factors you see in the Table 2 below are 0.95 ($1 \div 1.05$), 0.91 ($1 \div 1.05^2$), 0.86 ($1 \div 1.05^3$) and so on.

c) Discounting all Future Cash Flows to Present Value (DV)

The 'Discounted Value' of all the future cash flows (DV) is derived from multiplying the projected cash flow with the discount factor (DV = Cash Flow (Projected) x Discount Factor). From Table 2, you can see that the discounted values (DV) of all the future cash flow are worth $554.39m, $607.18m, $665.01m, $728.35m and so on.

Table 2: Calculating Intrinsic Value for SGX

KEY IN THE VALUES IN WHITE BOX

Name of Stock	Singapore Exchange
Stock Symbol	SGX
Operating Cash Flow (current)	$506.18 millions
Cash flow growth rate	15.00%
No. of Shares Outstanding	1,068.7 millions

PV of 10 yr Cash flows	$8,636 million
Intrinsic Value per share	$8.08

Current Year	2008	NB: Take the last Fiscal Year as the Curren
Discount Rate	5%	NB: Use the 3 months US Treasury Rate

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Cash Flow (Projected)	$582.10	$669.42	$769.83	$885.31	$1,018.10	$1,170.82	$1,346.44	$1,548.41	$1,780.67	$2,047.77
Discount Factor	0.95	0.91	0.86	0.82	0.78	0.75	0.71	0.68	0.64	0.61
Discounted Value	$554.39	$607.18	$665.01	$728.35	$797.71	$873.68	$956.89	$1,048.02	$1,147.84	$1,257.15

The intrinsic value of the whole company (i.e. SGX) would be the sum of all the future 'Discounted Cash Flow' for the next 10 years

= Add up all the Discounted Values

= $554.39 m + $607.18m + $665.01m +...+ $1,257.15m

= $8,636 million (PV of 10yr Cash Flows)

Now that we know how much the whole company is worth, how much is one share of stock worth?

To get the intrinsic value of **one stock** - take $8,636 million and divide it by the total number of shares outstanding (i.e. 1,068.7 million shares).

So, the **intrinsic value of one stock** = $\frac{\textbf{\$8,636 million}}{\textbf{1,068.7 million}}$

= **$8.08 per share**

As of 2 December 2008, SGX stock price is $4.68. So it is 42% undervalued and has a margin of safety.

Step 8: Stock Price is On an Uptrend

Finally, it is always safest to wait for the stock price to reverse into an uptrend and break above its 20-day or 50-day moving average before making an entry. Again, you can visit www.shareinvestor.com to view price charts for various time periods.

Chart 35: SGX 2-Year Chart captured from www.shareinvestor.com

Chart 36: SGX 3-Month Chart Capture from www.shareinvestor.com

As you can see, SGX's stock price is still on a downtrend and has not broken above the 20 or 50-day moving averages. So, it will be good to put this stock on your watchlist and consider buying once the price breaks above the mobbing averages and starts a new uptrend.

Start Building a Watchlist of Great Stocks

With the strategies you have learned, you can now start searching for and research the stocks you want to invest in.

Now, you may be wondering where to start. There are over 900+ stocks that are listed on the Singapore exchange and another 10,000+ listed on the US exchanges. It is probably a good idea to start by

researching companies that you are familiar with and better still, companies whose products you use.

If you were to study the greatest stock picks that Warren Buffet ever made in his career, they would be Coca-Cola, The Washington Post, American Express, Nike and Anheuser-Busch (maker of Budweiser beer). Why did he pick those companies? It is because he uses those products himself and understands their businesses well.

So, the same thing should go for you. What products and services do you buy on a regular basis? If you are buying those products, chances are, millions of other people are too. Where do you eat? What do you wear? What do you drink? What do you buy when you are out shopping? Look for both US companies as well as local companies you understand.

For example, I currently or used to patronize the following businesses regularly. And that is why I have invested in them before and right now while their share prices are depressed.

US Companies with Economic Moats

- **McDonalds (NYSE:MCD):**
  I eat there at least once a week
- **PepsiCo (NYSE: PEP):**
  I love their salty snacks
- **Google (NASDAQ:GOOG):**
  I use Google search/mail everyday

- **Boeing (NYSE: BA):**
  Makes half the planes I travel on
- **Proctor & Gamble (NYSE: PG):**
  Makes all my toiletries
- **Exxon Mobil (NYSE: XOM):**
  My regular gas stations
- **Visa (NYSE: V)**
  I use my Visa credit card everyday

Singapore Companies with Economic Moats

- **Singapore Airlines**
  My favourite airline
- **CapitaLand**
  Developed a couple of properties I owned
- **United Overseas Bank**
  One of the banks I use
- **SMRT**
  Almost everyone in my country pays them money daily
- **Singapore Exchange (SGX)**
  Guess who gets paid commissions whenever I buy shares in Singapore

All great investors build a watchlist of great companies that they keep an eye on. It helps them to get ready to strike when the time is right (i.e. when the stock price starts on a new uptrend).

Creating a Balanced & Diversified Portfolio

One of the first and most basic rules about investing is to diversify and not to put all your eggs in one basket.

No matter how good a company is, never ever put more than 20% of your money in that one stock. History has showed that no matter how strong a company has been or how long it has been around, anything can happen. No one would have ever thought that Lehman brothers, Bear Stearns, AIG, Enron or WorldCom could have suffered the fates they did. They were once the largest and strongest companies in the world.

At the same time, never put all your money into one sector/industry or even one country. For example, if you had put all your money in US financial stocks only, you might probably be trying to hang yourself right now. If you had put some of your money into oil stocks, commodity stocks and defensive stocks (i.e. McDonald's, PepsiCo), the profits you would have made on these other companies would have reduced or offset the losses on your financial stocks.

I always ensure that my stock portfolio has stocks from different sectors/industries like technology, financials, consumer goods, oil & gas and property for example.

What Every Portfolio Should Have

Whatever sectors/industries you choose to put your money into, I suggest that you include inflationary driven stocks and defensive stocks.

Whether we like it or not, inflation will always cause prices of good and services to go higher in the future. At the same time, as world oil reserves deplete and demand for oil will only increase over time, it means its prices will definitely keep going up. So instead of bitching and complaining, why don't we take advantage of this fact? Buy stocks that will benefit from inflation and higher oil prices!

Inflationary driven stocks/ETFs would include property stocks, REITs (Real Estate Investment Trusts), commodity stocks and stocks of energy and oil companies like Exxon Mobil. Alternatively, you could just put some of your money into an oil ETF like the United States Oil Fund (AMEX: USO).

It is also always good to include defensive stocks into your portfolio. Defensive stocks are stocks that people buy up during recession and downturns and hence their prices tend hold steady or move up while the overall market is bearish. They include food, utilities, defense, tobacco (people actually smoke more in bad times) and oil.

Examples of defensive stocks in Singapore would include Asia Pacific Breweries (APB), SMRT, Singapore Press Holdings (SPH). In the US, examples would include McDonalds, PepsiCo, Kraft and Lockheed Martin.

7

Finding Market Bottoms & Tops Using Patterns

Finding Market Bottoms & Tops Using Patterns

In the previous chapter, it was mentioned that the investing greats do not wait till prices hit exact rock bottom before buying. That's because there is no way to know for certain when that will be. So instead, they are happy enough just to buy NEAR the bottom.

To achieve this, savvy investors look out for patterns in stock prices and apply what is known as technical analysis. The techniques help them lower their risks entering the market, i.e. at points of expected good upside potential.

And just by virtue of the techniques being widely practiced, investors may find themselves jumping on the same bandwagon following the same patterns – somewhat resulting in a self-fulfilling prophecy. There will be more on this at the later half of this chapter. As incredible as it sounds, this phenomenon is so reliable that such patterns have been given names and titles which make it easy for other not-so-savvy investors to identify and pick up.

But before we get ahead of ourselves, let's start from the most basic (and most reliable) of technical analysis techniques.

Support, Resistance and Trends

While these concepts were mentioned briefly in the earlier chapters, we will explore them in greater depth here These refer to particular price levels which have historically acted as 'barriers' to the stock price movement.

For example, a support is an imaginary line at a specific level below the current price that prevents the price from dropping below it. In other words, it literally supports the stock movement trend and generates the stock confidence. For signals of whether prices have reached a bottom, investors usually look at past patterns in the form of long term historical supports or the 52-week low.

Chart 37: Line of Support

It will take some practice to deduce where a good line of support is. A possible option is illustration on chart 37. There is no exact right or wrong way to do it. Usually a straight line is drawn across the lowest points. This gives hint to where the next lowest point may be.

The chart shows that the stock price through history has been unable to break through the barrier of the support line – a strong indication of how it would likely behave going forward.

In order to determine if the line of support is reliable, wise investors will wait for the stock price to RETEST its lows.

This is useful when combined with other information such as trading volume – together helping to predict future price movements. For instance, when volumes show a steady decline, this is an indication that the current trend is losing interest. This is called a price-to-volume divergence, as illustrated by the chart featuring a stock called HOV below. A reliable trend should always have consistent or increasing volumes.

Chart 38: HOV: Price and Volume trend

Other reliable indications can be found in the very dependable 200-day simple moving average (200DSMA) as indicated below. If the stock moves below the 200DSMA, it traditionally indicates a bearish or "Sell" signal. When the price moves above the 200DSMA, this is a bullish indication or "buy" signal.

Chart 39: Using 200DSMA as Signal

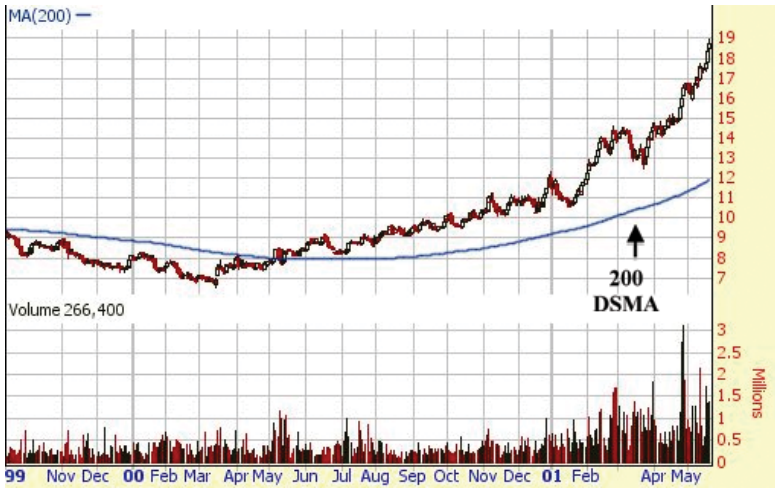
The 200DSMA is such a significant indicator that it is often used to determine whether markets are bullish (optimistic- moving up) or bearish (pessimisic- moving down).

Chart 40: 200DSMA on the S&P500 Index

Should a benchmark index (e.g. S&P500 above) fall below the 200DSMA, that market is deemed to be technically bearish. (An officially bearish market is one that has lost 20% of its value from its recent highs).

Conversely, the index is deemed bullish when it comes off its lows and crosses over the 200DSMA in an uptrend. At this point, it would not be uncommon to see buying interest increase. This trend can be confirmed by the higher-than-average volumes that would accompany it.

Chart 41: 200DSMA close to price level



Occasionally, as illustrated with the chart above, the 200DSMA will fall close to the stock price level. This can happen when it is consolidating (not moving up or down) at a bottom or a significant support level. This is also a very good opportunity to look for an entry.

An important condition to note before buying is that the volume does not start to wane as the price nears or crosses over the 200DSMA. This indicates a false breakout. It is crucial that volumes increase for the breakout to be reliable; thereafter volumes have to be consistent for a reliable trend. In the case of the stock above, volumes steadily increased in tandem with its uptrend.

Line of Resistance

Lines of resistance are the opposite of those of support. They 'prevent' prices from breaking above a specific

level. It induces a bearish (pessimistic) sentiment due to psychological fear and doubt.

Chart 42: The Resistance Line

As an investment rule, never buy near or at a historical 52-week high even if volumes are favorable. That's because a herd instinct may prevail, attracting a crowd of novices and the unknowing when the game is almost over. As Warren Buffet so aptly put it; when the market is greedy, you should be fearful.

And because the focus of the book is about buying bottoms, we will not spend too much time discussing the concept of resistance at length. But one good point to note about resistance and trends is a pattern known as the Parabolic curve.

Identifying Common Chart Patterns

Often when a stock appears to be profitable and highly in demand on a short term chart, excessive buying sentiment can quickly turn it into an overvalued rocket. When this happens, taking a step back to look at a long term chart will show you what appears to be the start of a roller coaster ride; it is building up to a peak for what will be the big drop! (the start of a downtrend).

Chart 43: Parabolic Curve

To avoid getting caught in this silent killer, remember to always have many perspectives when looking at your charts. Don't fall victim to the routine of looking at a fixed duration chart like a one-year or two-year chart.

For example, a five-month chart (MOS, below), may

reveal a beautiful uptrend that will always be too irresistible.

Chart 44: Five-month chart – Mosiac Company (MOS)

However changing the perspective of the MOS chart to one of a longer term (e.g. four years) will reveal a very scary prospect and one which obviously carries a lot of risk.

Chart 45: Four-Year chart – Mosaic Company (MOS)

You may want to consider taking your money off the table before it's too late. Sure enough, MOS's stock price crashed shortly after.

Chart 46: Typical Parabolic Curve Aftermath - MOS

When considering an entry, patterns are always a good way to time your entry. The method is quite simple and with practice becomes common sense. Let's look at some of the most common patterns that signify market bottoms and how we can time our entry to use our friend, the trend.

Various Other Chart Patterns

Chart 47: Double Bottoms

Chart 48: Inverted Head and Shoulders

Chart 49: The Cup and Handle

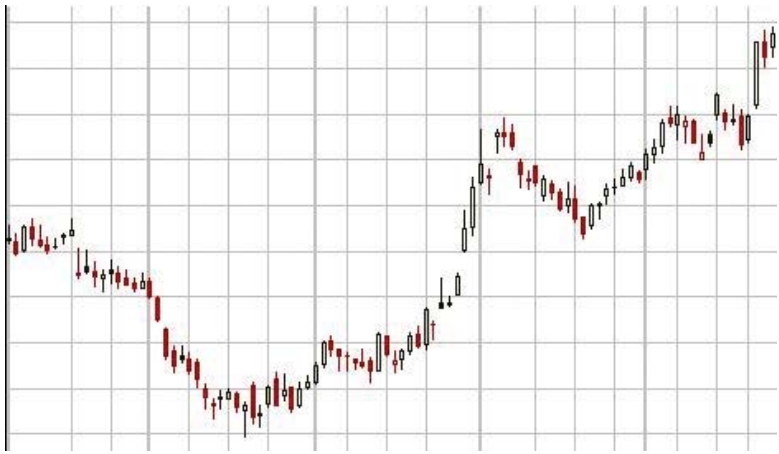


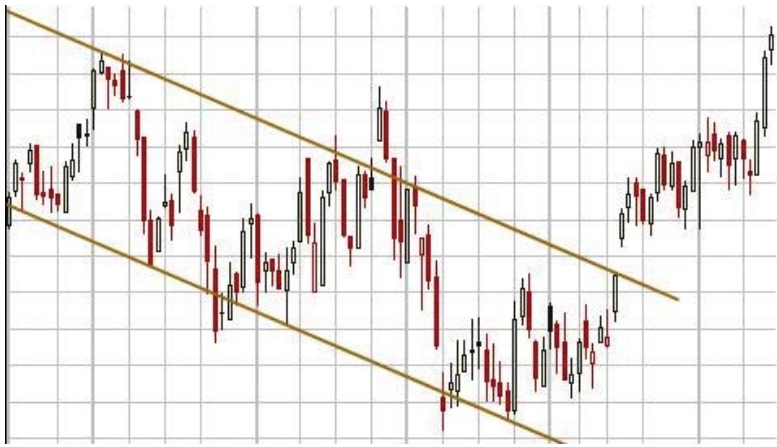
Chart 50: Consolidation Breakouts

Chart 51: Round Bottoms and V-bottoms

Chart 52: Falling Wedges

Chart 53: Triangles

Chart 54: Channels



Market Cycles and Self-fulfilling Prophecies

The market is a predominantly irrational place filled with many investors who will believe anything and everything. Therefore, it is not a surprise that superstition and self-fulfilling prophecies prevail. That's actually not a bad thing if you realise how you can leverage on knowing when and what will happen. It can help you decide whether to profit take or hedge your position.

Here are some interesting events that have been observed to happen. However it is important to note there are exceptions when they do not occur.

Pattern 1: January Barometer

Often used by analysts as an indication of the year's sentiment. If January ends down, the year to follow

will be bearish (downward trend). If it closes up, the year will be bullish (upward trend).

During election years when the first five days of January closed down with the month of January also down, the year had always closed negative.

Pattern 2: The January Effect

Here's a bit of January Effect Trivia: Traditionally in bullish years, the 10 best performing stocks on the S&P 500 will end the year up, while the 10 worst performers will go down.

Pattern 3: Sell in May and Go Away

A trader's superstition that has more credit than most would like to admit. The months from November to April are often bullish, while May to Halloween (end October) are bearish. September is traditionally one of the worst months of the trading year.

Pattern 4: October Effect

In October, the market gets very nervous because the month through history has recorded some of the largest historical market crashes. This includes Black Monday, Tuesday and Thursday - all in October 1929 - after which came the Great Depression.

The crash of 1987 occurred on October 19 which saw the Dow plunge 22.6% in a single day. And most recently, the bloody Friday on October 24 where many of the world's stock exchanges experienced the worst declines in their history.

However, the October effect is nowadays considered mainly to be a psychological expectation rather than an actual phenomenon. That's because most statistics go against the theory.

Pattern 5: Santa Claus Rally

This is a surge in stock prices that often occurs in the week between Christmas and New Year's Day. A few events contribute to the reliability of this:

- Pre-holiday rallies for Christmas Eve and New Year's Eve.
- Index Addition - Changes in the Major Indices' basket of stocks
- Investors pumping in extra funds from year-end bonuses and incentive pay outs
- Fund Managers shopping for End of the Quarter Window Dressings

Other interesting trivia:

1) The first trading day of the month is reliably a very bullish day – often the month's most bullish.
2) April is the most bullish month of any trading year.
3) Quarter 3 is the worse quarter of the trading year starting with July and ending with September – with September being the worst of those three months.
4) November, December and January make up the best three months of a trading year.
5) The end of October starts the best six months on the S&P500 and the start of the best eight months on the NASDAQ.

6) An Inverted Yield Curve (IYC – when the shorter term bonds yield more than the longer term notes) at the start of a trading year is a forward indication of a "soft" economy in the next year.
7) A down Friday followed by a down Monday is a unique and reliable phenomenon that signals growing weakness in the market the more frequently it occurs.
8) Years ending with "7" have spelt bad fortune through history;
   a. 2007 (Sub-prime Mortgage Crisis)
   b. 1997 (Asian Financial Crisis)
   c. 1987 (Recession)
   d. 1957 (DOW Triple Top)
   e. 1937 (Property Bubble and Credit Tightening)
   f. 1917 (Inflation – WWI)
   g. 1907 (Post San-Francisco Earthquake)
9) Years ending with "5" have spelt good fortune because 10 out of 11 have rallied in the last 110 years
10) When the market bottoms out on a year ending with "2", the market will rally for at least the following four years; 1932-37, 1942-46, 1962-66, 1982-87 and 2002-06.

Economic Data and Reports

The market is constantly being bombarded with economic data that will move sectors and industries in the short term. Amidst all this information, there are several key reports that active investors should monitor to protect their portfolio. Let's concentrate on the ones that monetary authorities take keen interest in.

After all, if they are interested in such reports, shouldn't we be too?

Data 1: Interest Rates

In simple terms, interest rates dictate the price of money (i.e. how much it costs to borrow). Lowering it encourages borrowing/spending to stimulate economy. Raising it puts the brakes on inflation. This control helps to balance the economy and stabilize prices and its currency.

The rise and fall of interest rates usually causes stock prices to move. However, in recent times, the market has taken on a habit of "pricing-in" any possible adverse reactions to such announcements. In other words, if the market anticipates that prices would drop following the announcement, prices would have already been pushed up about a week in advance. Thus, any following fallout would bring prices down to an acceptable level or at the level before the pricing-in exercise.

On the actual day of announcement, the market is likely to experience a knee jerk reaction to the news. However, it will quickly recover to continue the current trend. A trend change will happen only when the announcement presents a totally unexpected surprise.

As a guide, when interest rates fall the market spikes up in the short term. But in the long term, the market follows the direction of the interest rate and goes down. Conversely when interest rates rise, the market

will fall but eventually in the long term follow the direction of the rate up.

Interest Rate Direction	Short Term Market Reaction
Interest Rates Up (tighten)	Market goes down
Interest Rates Down (Ease)	Market goes up

GDP (Gross Domestic Product)

(Occasionally this report is issued in the third week of the month, at about 8.30am (US Market))

What it is: the GDP is the broadest measure of a country's economic activity and includes current statistics relating to growth in every sector and industry group. This report can easily move the stock market.

Note: Two consecutive quarters of negative GDP confirms an economy in recession.

GDP Direction	Short Term Market Reaction
GDP Up (Expansion)	Market goes up
GDP Down (Contraction)	Market goes down

Data 2: Employment Situation

This is particularly important for the US market. The "employment numbers" are an important set of labour-related statistics that include – but are not limited to – the unemployment rate, ***non-farm payroll*** employment (the number of part-time and full-time employees in business and government establishments), and average hourly earnings. All these figures give clues to the state of the economy and paint its future outlook.

The US Non-Farm Payrolls report is released on the first Friday of every month. The authorities in charge of monetary policy (Federal Open Market Committee) watch this report closely. So should you!

For dates of non-farm payrolls in other economies, log on to www.forexfactory.com

Non-Farm Payrolls	Short Term Market Reaction
Non-Farm Payrolls Up	Market goes up
Non-Farm Payrolls Down	Market goes down

Data 3: PPI (Producer Price Index)

This measures the prices of goods at the wholesale or manufacturing level. When inflation is low, this report

is not so important. However when inflation is an issue, it can affect the manufacturing sector and have a domino effect on the consumer level and the CPI (Consumer Price Index).

Data 4: CPI (Consumer Price Index)

This is a measure of the average price level of a fixed basket of goods and services purchased by consumers. This is a key report because changes in the CPI indicate changes in the rate of inflation. (Inflation = the rise in cost of goods and services.)

In general, an increase in the PPI or the CPI indicates a rise in inflation, stoking fears that the Federal Reserve may raise interest rates to control inflation. This leads to a short-term drop in stock prices.

PPI &CPI Direction	Short Term Market Reaction
PPI & CPI up (inflation)	Market goes down
PPI & CPI (deflation)	Market goes up

Data 5: ISM Index

The Institute for Supply Management surveys approximately 400 manufacturers. Information results in a composite report detailing production, new orders, inventories, supplier delivers and employment. A reading above 50% indicates an expanding factory

sector and a bullish sentment. A reading below 50% indicates contracting conditions and a bearish sentiment.

ISM Index Reaction	Short Term Market Reaction
ISM Index Up (expansion)	Market goes up
ISM index Down (contraction)	Market goes down

Hopefully, this chapter has given you a better idea as to the many factors that affect stock market prices. Besides the obvious value of the company's stock purchased, investors' psychology (reflected in chart patterns and self-fulfilling prophecies) as well as economic data plays a big part into how well your investments will do. So, do dilligently monitor all these factors before making any buy and sell decisions.

8

Starting Your Journey as a Successful Investor

Starting Your Journey as a Successful Investor

I would like to start off this final chapter by congratulating your for having the commitment to finish this book. If you are someone who has little background in finance, I can understand that it could have been a challenge learning all the information that has been thrown at you so far. It is this hunger for learning that is so essential to becoming a great investor. You must have the curiosity and patience to spend the hours necessary to research companies before finding a stock buy that will provide huge profit opportunities

Let's do a quick recap about what you have learnt so far. In chapter one, you were introduced to the beginnings of the financial crisis, its devastating impact and the once in a lifetime opportunity it presents to you as an investor. You now know that it is not the external events (market downturns, recessions, market rallies) that determine our financial success, rather, it is the financial decisions we make that ultimately determine our financial destiny. To make the best decisions, you have to first equip yourself with the best financial education.

In chapter two, you got a crash course on how markets work. You learnt that stock markets (represented by indexes) are highly volatile in the short term. However,

in the long term, inflation, population and economic growth always drive stock prices higher.

In chapters three and four, you learnt that the easiest, no-brainer way to make money from the markets is to just buy the market index. Opportunities abound in markets like the US, UK, Singapore, China and other emerging markets. Using economic indicators, technical analysis and pure common sense, you should enter markets when prices are low (in times of extreme pessimism) and sell when prices are high (in times of extreme optimism).

In chapters five and six, you learnt the Warren Buffett way of being a selective contrarian value investor. By selecting very good companies and buying their stocks at huge discounts to intrinsic value, you set yourself up for handsome returns when the market recovers.

In chapter seven, you learnt some extra tips on how to identify market tops and bottoms using stock price patterns and other market indicators.

Investing is Hard Work

You may be beginning to discover that investing involves a lot of hard work. Well, let me tell you that IT DOES! One reason why many people fail as investors is because they think that investing is an easy way to make money. They treat it like a get-rich-quick scheme and play the stock market like they would a casino.

Truly successful investors know that there is NO FREE LUNCH in this world. You can never make money consistently without hard work. Investing is a job just like any other job. If you study professional investors like Peter Lynch, George Soros, Warren Buffett or Sir John Templeton, you would realize that they work equally AS HARD as other business billionaires. They spend hours, days, weeks and even months reading reports, news and perform in depth research. 99% of the work you do as an investor is the research before the buying and 1% is the actual buying, holding and selling of the stock opportunity.

Stay Diversified, But Not Too Much

When Lehman Brothers filed for bankruptcy in late 2008 and Merrill Lynch sold itself to Bank of America to avert the same fate, thousands of investors in Singapore lost millions of dollars in mini-bonds that were sold to them by their bankers. News headlines recounted how many people, many of whom were retirees, lost their entire life savings after seeing their investments go to zero.

While the banks are now under fire for possibly misleading their customers that these mini-bonds and structured notes were very safe and 'capital protected', I believe that these investors should also take some responsibility for committing the ultimate mistake, putting all their eggs in one basket.

No matter how great or how safe any investment may seem, NEVER, EVER put all your money in one

security. In fact, the way you allocate your funds across different assets will make a big difference to the risk you take to make potential returns. In my Wealth Academy Live Seminars and previous books, 'Secrets of Self-Made Millionaires' and 'Secrets of Millionaire investors', I talk in depth of how you should divide your money between index ETFs, value stocks, fixed deposits/cash equivalents and property.

At the same time, you also don't want to divide your money between too many different investments (more than 10-12). Instead of reducing your risk, it may have the reverse effect of increasing it. When you take on too many investments, you will not be able to spend enough time to understand, study and monitor each one well enough to make the right decisions. In fact, Buffett once remarked that people who buy everything and diversify too much do so to protect themselves against their own ignorance.

The Market is too Dynamic for Absolutes

The reason why you should never put all your money in any kind of investment is because the stock market is too dynamic for absolutes. There is NO investment strategy that can guarantee you profits all of the time. There is no investment expert who is right ALL of the time.

No matter how much work you do, how great your information is and how perfect the numbers look, things can go wrong that can never be predicted!

For example, nobody ever thought that AIG could go from $80 to $1.70 in less than 12 months. Before the crisis erupted, it had a history of consistent earnings growth, an impenetrable competitive advantage and one of the strongest balance sheets for any financial company (rated AA+) by top rating agencies. Sometimes, the stock market may even work in an irrational way.

For example, on the 5th of November, 2007, the economic data showed that there was a record number of jobs lost (more than 500,000) in the US in the previous quarter, signalling a deepening of the recession that was gripping the world's largest economy. Guess what happened? Instead of pushing the market lower, The Dow Jones reversed from a loss of 250 points to a strong gain of 250 points by the close!

In fact, even the very best investors and traders in the world don't make profitable investments all of the time. If you study their trades, you will realize that they will be right and make money 6-7 out of 10 times at the most! What makes them profitable is their consistency in applying their strategies and their ability to control their losing trades. In fact…

It's Not How Much You Make, It is How Much You Lose

George Soros, one of the world's top traders and investors once remarked, "it is not whether you are right or wrong. It is how much money you make when

you are right and how much you lose when you are wrong".

Soros is often regarded as a genius for being able to make correct bets on market directions. In 1997, he made billions of dollars shorting the British Pound, almost breaking the Bank of England. However, if you study his moves, you will find that he makes as many wrong predictions as he does correct ones. The only difference is that when he realizes he made a mistake; he gets out of the market and minimizes his losses. When he his right, he stays in the market, riding his investments to its fullest potential.

So, watch you investments closely and have the discipline to sell and cut your losses when you realize that you have made a mistakes or when new data emerges that makes your investments no longer a good one. I tell my students at Wealth Academy to spend just 10 minutes a day to monitor their portfolio and once a quarter to do a financial review.

Using Automated Stop-Losses

One of the best tools you can use if you are afraid that you may not have the discipline to constantly monitor your investments is a STOP-LOSS. A Stop-Loss is an order that an investor can place with the broker to protect his capital - just in case the investment falls below a certain tolerance limit.

For example, your $1,000 stock might drop to $800, and you might be worried it could plunge further.

While you wait to see if it might pick up again, you could set an automatic order to sell just in case it drops to $700. It is somewhat like an automatic ejection seat.

This is useful for many reasons. This includes the probability that you would not have time to constantly monitor the markets and that it is a form of disciplined planning. Not everybody likes using Stop-Losses and not many do. But you should consider its value; would investors have lost as much during the market collapse in 2008 if they had stops in place?

Although it's commonly called a Stop-Loss, the Stop is also a tool to protect profits. It can prevent your gains from getting completely wiped out in a plunging market. Remember that you have no idea where the next market top or crash is. It could well happen before your investment realizes its intrinsic value.

In such a situation, you may not have considered an acceptable exit on your investment when a sell-off catches you off guard. Before you can react, you would have lost a fair portion of your profits. Your psychology would then start to play on your common sense. The most natural and common reaction is to hang on to the investment in the hope of getting back that loss. Unfortunately that often never happens when a market begins its bear run. And it is for this reason that even wealthy investors lose millions during a bear market.

The simple practice of placing stops and knowing when to raise the stop level will save you a lot of agony later. It will also put discipline into the way you invest. Best of all, it removes the need to battle your fear and/or greed.

Chart 55: Placing and Adjusting Stops (An Example from an investment in Goldman Sachs (GS)

Here is an example of how you could place a stop loss order on an investment in Goldman Sachs (GS) and re-adjust your stop loss price as the stock price goes up in order to protect our profits in case of a sudden reversal.

1. Investor buys GS at $90.
2. GS makes gains. Investor places a stop loss for his entire investment at $110 after GS makes a slight dip.

3. After a lengthy consolidation (move sideways), GS continues its uptrend. Investor repositions his stop for two-thirds of his investment at $145 while keeping a third at his original $110 stop.
4. After another dip in the uptrend, he raises his stop again. This time, he raises half of the $145 stop to $190.

This leaves our investor with a third of his positions protected at $110 for a $20 profit, a third at $145 protecting a $55 profit and the last third at $190 protecting $100 of profits. This style of "staging" stops is meant to allow the stock to make the occasional irrational correction and still allow the investor to stay invested for the longer term.

For example, when GS made a massive correction in the middle of 2007, our investor would have been stopped out at $190 (a). In others words, the broker would have automatically sold your stock at $190, taking you out of the market. This immediately puts $100 per share into our investor's pocket and allows him to stay invested for the remaining two-thirds of his positions.

As GS made a new high at $240, he could have chosen to take more money off the table or do nothing and leave his stops to protect his remaining positions. Otherwise he could have raised his stops to a higher level to 'lock in' more profits.

In the worst-case scenario, our investor would have left all his stops in place. Even when GS dropped into

oblivion, our investor would not have lost anything. Better yet, he would have made a profit as he got stopped out at (b) for $55 per share and finally at (c) for $20 per share.

I'm sure you agree this is much better than holding on to GS till the end of November 2007 when its share price plunged to $50! If the initial investment outlay was $90, that would account for a loss of $40 per share on the entire investment.

Get into the good habit of using stops. The world would probably not be in such a crisis if investors had used stops to protect their investments.

Identifying and Managing Your Strengths and Weaknesses

Before you start investing, it is essential that you first identify your personal strengths and weaknesses. You will need to be completely honest with yourself. You won't be able to get past this first step if you are the sort who lives in denial. Otherwise you will always be overlooking your faults and blaming the system.

After identifying your weaknesses, figure out how you can manage it; this could include avoiding circumstances that would expose your weaknesses. For example if you tend to procrastinate, you will be the kind of investor who will hesitate in cutting losses. Avoid that situation by automating your trades with Stop Loss orders.

Being patient is often good. However it is a fine line between that and being indecisive. If you adopt too much of a wait-and-see attitude, the ship may have sailed by the time you have decided how to react. You can avoid this situation by applying profit and time targets.

I have come to realise that the way you invest is a reflection of your personality. It reflects the way you think, your discipline, and how you react to your emotions.

For instance if you're the type of person who doesn't count the small change you get back at the supermarket, it will be mirrored in your investing mentality. Soon, you'll be asking why the market has short-changed you or wonder why your profits don't quite tally with your estimations.

If you're the sort who shops on impulse, without checking out competitive prices or scrutinizing your product for minor defaults, then you'll find yourself buying losing stocks because you listened to rumours and made short cuts in your own research.

Perhaps you follow fashion trends after everybody else; you might be the sort who jumps into market opportunities a little late. When you finally get out of the sidelines to buy a rising stock, it would have started to reverse into losses.

As you can see, more than 70% of an investor's success lies in his/her psychology and the remaining 30%, the

strategy. This is why at the Wealth Academy and Wealth Academy Trader Live seminars, a lot of time is spent addressing psychological issues before teaching the technical methods.

Your Education Journey Continues

Note from Adam and Conrad

As we come to the end of this book, I want you to know that it does not mark the end of your learning journey but just the beginning. There is still a lot more that I urge you to learn before putting your money on the line.

Remember that we spend an average of about three years (4,680 hours) studying in college/university to get the knowledge and training required to perform a job competently and earn a starting salary of $2,000-$3,000. Don't you think it makes sense that you need to also spend a lot more time learning and practicing how to invest before you can start making great investment decisions?

Thankfully, there is a way to accelerate the whole process. This is precisely why we spend the time to conduct our live Wealth Academy and Wealth Academy Trader for novices and experienced investors alike. We want to help as many people as possible learn the RIGHT way of how to invest so that they too can reach their financial goals. If you want to know more about our programmes, visit www.akltg.com or call our Singapore Head Office at 65-62740105 to get a free brochure or to speak to one of our program consultants.

In the meantime, we wish you all the very best in your quest for financial freedom and look forward to hearing your success story soon. You can contact us by visiting us at our BLOGs at www.adam-khoo.com and www.conradalvinlim.com

Adam Khoo's Life Transformational Programs

ADAM KHOO LEARNING TECHNOLOGIES GROUP

Public Seminars Division

- Patterns of Excellence™
  - o Empowerment (3 days)
  - o Influence and Mastery (3 days)
- Wealth Academy (4 days), Wealth Academy Trader (5 days), Wealth Academy Forex (3 days) and Wealth Academy Options (3 days).
- Millionaire Business Academy (6 Days)
- 'I Am Gifted, So Are You!' Camp for Teens (11 weeks)
- Superkids™ Camp for Children aged 10-12 (11 weeks)

* Selected seminars are currently being conducted in Singapore, Malaysia (Kuala Lumpur, Penang & Johor Bahru) and Indonesia (Jakarta, Surabaya & Medan), Thailand (Bangkok) and China (Hangzhou)

Schools Division

- 'I Am Gifted, So Are You!' Workshop for Teens
- Superkids™ Camp for Children aged 10-12
- Customized Life skills Training
- Outdoor Adventure and Leadership Training
- Transformational Teaching
- Money & Business Workshop for Teens

Corporate Division

- Accelerated Learning for Business
- Peak Performance Selling
- Public Speaking & Communication Strategies
- Personal Mastery & Team Building
- Leadership Training

For more information, call 65-62740105 or visit www.akltg.com

Adam Khoo
Learning Technologies Group

Singapore

Adam Khoo Learning Technologies Group Pte Ltd
10 Hoe Chiang Road #01-05 Keppel Towers Singapore 089315
Tel: (65) 62740105 Fax: (65) 62245291
Visit us at: www.adamkhooeducation.com

Adam Khoo Learning Centre Pte Ltd
238 Thomson Road, Novena Square, #03-28, Singapore 307683
Tel: (65) 6765 5516 Fax: (65) 6765 6959
Visit us at www.superlearner.com

Malaysia

Adam Khoo Learning Technologies Group Sdn Bhd
B-2-12 TTDI Plaza Jalan Wan Kadir 3,
Taman Tun Dr Ismail,
60000 Kuala Lumpur, Malaysia
Tel: (603) 7725 0212 Fax: (603) 7725 8212
Visit us at: www.adamkhooeducation.com

Indonesia

PT Adam Khoo Learning Technologies Group
Wisma 46 Kota BNI, 2nd Floor, Suite 2.05
Jl. Jendral Sudirman Kav. 1 Jakarta 10220
Tel: (62) 21 574 7511 Fax: (62) 21 574 7501
Visit us at: www.adamkhooeducation.com

Thailand

Adam Khoo Education Group Co., Ltd
10th Floor, Dusit Thani Building,
946 Rama 4 Road, Silom Bangkok 10500, Thailand
Tel: (66) 2636 3211 Fax: (66) 2236 3059

How to Profit from the Greatest Investment Opportunity Since the Great Depression

"Will you become richer or poorer after a recession?"

The answer depends on what financial decisions you make TODAY. If you do nothing, you will become poorer. If you do the wrong thing, you will also become poorer. If you do the right thing, you will significantly expand your wealth!

When the markets see red, the greatest investors see opportunity. Many of them like Warren Buffett are BUYING up stock, instead of selling it like most people. They have done it before in past financial crises, making their billions. Now they are doing it AGAIN.

Educate yourself now or miss out on the greatest wealth building opportunity in your lifetime!

What You Will Learn in this Book

- Understand how the financial crisis started and its implications
- Why most people lose money in the stock market and learn how to win big like the minority
- Why the stock market will eventually recover and how to position yourself for the next bull run in Asia and the US
- How to identify market tops, turning points and bottoms
- Discover which sectors and stocks will be the first to rebound
- How to find great undervalued stocks amidst the chaos
- How to take advantage of the 70% plunge in the China Index, the 61% correction in the Singapore market and the 45% drop in the US market
- Keys to building a balanced and diversified portfolio
- How to inflation-proof your portfolio and protect yourself from future downturns